Supreme Court, U.S.
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No. 95-___

In The

Supreme Court of the United States

October Term, 1995

THE PRICE COMPANY, ROBERT E. PRICE, DENNIS R. ZOOK and THEODORE WALLACE,

Petitioners,

v.

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO and JOSEPH LASENSKY, On Behalf of Themselves and All Others Similarly Situated,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether Federal Rule of Civil Procedure 9(b) – in the context of a securities fraud action filed the day after a disappointing quarterly earnings announcement caused a company's stock price to drop – requires plaintiffs to plead facts sufficient to raise an inference that the defendants acted with fraudulent intent in the period before the earnings release, as the First, Second and Seventh Circuit Courts of Appeals have held, or merely requires plaintiffs to allege an explanation why corporate statements preceding the earnings announcement were false or misleading when made, as held by the Ninth Circuit Court of Appeals, which applied this latter rule to reverse the district court's judgment of dismissal in this case.

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

Petitioners in this case are The Price Company, Robert E. Price, Dennis R. Zook and Theodore Wallace. Petitioners were defendants in the district court and appellees in the court of appeals.

Respondents Max Fecht, Norman Cooper, Hamilton J. Sah, Elaine Algeo and Joseph Lasensky were plaintiffs in the district court and appellants in the court of appeals.

Petitioner The Price Company is a wholly-owned subsidiary of Price/Costco, Inc., a publicly traded company.

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PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the court of appeals (App-1) is reported at 70 F.3d 1078 (9th Cir. 1995). The opinions and orders of the district court (App-15, 19, 60, 131 and 133) are unreported.

JURISDICTION

The judgment of the court of appeals was entered and filed on November 20, 1995. A petition for rehearing and suggestion for rehearing *en banc* was timely filed on December 4, 1995. The court of appeals on January 8, 1996 entered and filed its order denying the petition for rehearing and rejecting the suggestion for rehearing *en banc* (App-137). The court of appeals on January 18, 1996 entered and filed its order for stay of mandate pending the filing of a petition for writ of certiorari to this Court. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE AND RULE PROVISIONS INVOLVED

Federal Rule of Civil Procedure 9(b) provides as follows:

> **Fraud, Mistake, Condition of the Mind.** In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be

> stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

The underlying claims in this litigation are asserted under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b) and 15 U.S.C. § 78t(a), respectively) and SEC Rule 10b-5 promulgated under Section 10(b) of the Securities Exchange Act of 1934 (17 C.F.R. § 240.10b-5). Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact

> necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 20(a) provides as follows:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Also relevant to the issues raised by this petition is the Private Securities Litigation Reform Act of 1995, Public Law 104-67 (to be codified at 15 U.S.C. § 77), which became effective on December 22, 1995. The provisions of this Act are reproduced at App-140.

STATEMENT OF THE CASE

I. Proceedings in the District Court

On April 2, 1992, in the midst of a general recession, The Price Company announced positive net earnings of $20.6 million, or $0.42 per share, for the quarter ending March 15, 1992. This figure, while impressive, was less than the $0.56 per share earnings recorded during the

comparable quarter for the preceding year, and triggered a drop in the company's stock trading price. On the very next day, six law firms specializing in plaintiffs' securities litigation filed a 33-page securities fraud complaint accusing The Price Company and certain of its officers of fraud.

Plaintiffs premised their fraud claims on a series of selective quotations which plaintiffs excerpted from certain Price Company disclosure documents issued at various times before the April 2, 1992 quarterly earnings announcement. Plaintiffs asserted that these corporate disclosure documents were misleadingly optimistic, and failed to disclose material adverse information concerning business problems, risks and uncertainties. Before any responsive pleading was due, plaintiffs amended their complaint and added an overlay of excerpted quotations from certain third-party securities analyst reports, which plaintiffs asserted confirmed the alleged pattern of misleading disclosure by the Price Company defendants. Plaintiffs theorized (solely on "information and belief") that the Price Company defendants in the year-long period before April 2, 1992 had engaged in a conspiratorial scheme to inflate artificially the trading price of their company's stock by concealing adverse information, which allegedly was revealed only with the disappointing April 2, 1992 earnings announcement.

Defendants prepared a motion to dismiss and moved for a stay of specified discovery pending a ruling on the motion to dismiss. A United States magistrate granted the requested stay of discovery pending determination of the

motion to dismiss, and the district judge affirmed the magistrate's stay order.[1]

The district judge, upon consideration of defendants' motion to dismiss plaintiffs' first amended complaint under Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure, advised plaintiffs that their pastiche of selected quotations and paraphrases from corporate disclosure documents and analyst reports was a legally insufficient basis for their securities fraud claims. The district judge concluded that examination of the full text of the documents sued upon demonstrated that the matters allegedly concealed had been clearly and substantially disclosed by defendants.[2] Accordingly, the district

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[1] *See* App-19 (order of district court dated August 12, 1992 affirming magistrate's order staying discovery pending determination of defendants' motion to dismiss).

[2] *See* App-22 (transcript of district court September 21, 1992 hearing on defendants' motion to dismiss first amended complaint). At the September 21, 1992 hearing, the district court rejected plaintiffs' counsel's repeated assertion that The Price Company had failed to disclose material adverse information:

> THE COURT: I don't think so. I don't read that. They told you they were having all kinds of problems with their – with everything they were doing – was giving a problem. Warehouse expansion was giving them problems. Sluggish economy was giving them problems. Profitability was giving them problems. Profit margins were giving them problems. Expenses were giving them problems. They told you – problems, problems, problems, every time they opened their mouth.

App-54. The court also noted at the September 21, 1992 hearing that "what I don't see in the complaint is any allegation of facts which: (a) were adverse to the company's optimism; (b) were

judge granted defendants' motion to dismiss under Rules 9(b) and 12(b)(6), but allowed plaintiffs another opportunity to amend their pleading. *See* App-60 (order of district court dated October 1, 1992 granting motion to dismiss with leave to amend).[3]

Plaintiffs filed their second amended complaint on November 18, 1992. Although plaintiffs' second amended complaint added supplemental state law claims and was cosmetically amended in various respects, the second amended complaint set forth and relied on exactly the same set of excerpted document quotations and paraphrases which the district court had rejected as legally insufficient bases for suit. Defendants moved that the district court again dismiss plaintiffs' action, this time without leave to amend. After careful examination of the second amended complaint and the documents referenced therein, the district judge, after hearing argument of counsel on March 9, 1993, dismissed plaintiffs' action with prejudice.[4] In dismissing the action with prejudice after considering defendants' second motion to dismiss,

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known by the company; and (c) were concealed by the company; and (d) replaced with untrue, rosy facts." App-29.

[3] The district court ordered that the discovery stay would continue pending determination whether plaintiffs by further amendment could plead a legally sufficient complaint. *See* App-58.

[4] *See* App-62 (transcript of March 9, 1993 district court hearing on defendants' motion to dismiss second amended complaint); App-131 (order dated March 18, 1993 granting motion to dismiss second amended complaint without leave to amend); and App-133 (judgment in a civil case dated March 22, 1993).

the district court concluded that plaintiffs had not set forth their fraud claims with the particularity required by Rule 9(b) and had not stated any cognizable securities fraud claims under Rule 12(b)(6).[5]

Plaintiffs filed their notice of appeal on April 15, 1993.

II. Proceedings in the Court of Appeals

The appeal was heard by the United States Court of Appeals for the Ninth Circuit on October 4, 1994. Much of the discussion at oral argument centered on the special pleading requirements imposed by Rule 9(b) in securities fraud actions. The panel hearing the appeal made express reference at argument to the case of *In re GlenFed, Inc. Sec. Litig.*, No. 92-55419, in which the Ninth Circuit Court of Appeals had granted rehearing *en banc* and which then remained under submission by an *en banc* panel. The issue presented by the *GlenFed en banc* proceedings was whether Rule 9(b) required a securities fraud plaintiff to plead facts sufficient to raise a "strong inference" of fraudulent intent, as the three-judge *GlenFed* panel had held (following authorities from the Second Circuit Court

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[5] *See* App-72-73, 128. In the course of the March 9, 1993 hearing on defendants' second motion to dismiss, the district judge on the record methodically compared plaintiffs' allegations of fraud and nondisclosure with the contents of the actual source documents cited by plaintiffs in support of their claims. As the district court repeatedly demonstrated through specific examples, plaintiffs unfairly had portrayed the documents sued upon, which in reality refuted rather than supported plaintiffs' assertions that material adverse information had been concealed. *See* App-72-88, 102-108.

of Appeals), or whether Rule 9(b) imposed a lesser or different pleading standard.[6]

On October 20, 1994, the three-judge panel hearing the appeal in the *Price Company* case issued an order withdrawing "[s]ubmission of this case . . . until final disposition of the *In re GlenFed, Inc. Sec. Litig.*, No. 92-55419, now pending before this Court" (App-134). Thereafter, an *en banc* panel of the Ninth Circuit Court of Appeals issued its decision in the *GlenFed* case and set forth an interpretation of Rule 9(b)'s pleading requirements which diverges from the interpretations of other United States Courts of Appeals. *See In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541 (9th Cir. 1994).

The *en banc* panel in *GlenFed* expressly rejected any requirement that a plaintiff must plead sufficient facts to raise a "strong inference" or an "inference" of fraudulent intent, as the First, Second and Seventh Circuit Courts of Appeals have held.[7] Instead, the Ninth Circuit *en banc* panel in *GlenFed* held that *scienter* can be alleged generally and that a securities fraud plaintiff satisfies its burden under Rule 9(b) if it pleads an explanation as to why challenged statements were false or misleading when made. *Id.* at 1548-1549.

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[6] The opinion of the three-judge panel in *GlenFed* is reported at 11 F.3d 843 (9th Cir. 1993).

[7] *See, e.g., Greenstone v. Cambex Corp.*, 975 F.2d 22, 25-27 (1st Cir. 1992) (Breyer, J.); *O'Brien v. National Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *DiLeo v. Ernst & Young*, 901 F.2d 624, 630 (7th Cir. 1990), *cert. denied*, 498 U.S. 941 (1990).

On January 4, 1995, the three-judge panel of the Ninth Circuit Court of Appeals which had heard arguments in the *Price Company* case, issued an order resubmitting the *Price Company* appeal for determination (App-135). Thereafter, on June 16, 1995 this panel issued an order directing the parties to file supplemental briefs addressing the application of *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541 (9th Cir. 1994) (*en banc*) to the *Price Company* case (App-136).

After receipt of the requested supplemental briefing, the three-judge panel on November 20, 1995 entered and filed its opinion in this case (App-1). The court of appeals panel reversed the judgment of the district court, which had dismissed plaintiffs' securities fraud action under both Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. In its opinion reversing the district court and remanding the case for further proceedings, the Ninth Circuit panel expressly cited and relied upon the newly-adopted interpretation of Rule 9(b) set forth in the *GlenFed en banc* opinion: "[w]e believe that sufficient evidentiary facts are pleaded to explain why the Company's statements were false when made and, thus, to satisfy the requirements of Rule 9(b) as interpreted by *GlenFed*." (App-11.)

Petitioners timely filed a request for rehearing and suggestion for rehearing *en banc* with the Ninth Circuit Court of Appeals on December 4, 1995. On January 8, 1996, the Ninth Circuit Court of Appeals entered and filed its order denying the petition for rehearing and rejecting the suggestion for rehearing *en banc* (App-137).

On January 12, 1996, petitioners filed with the Ninth Circuit Court of Appeals a motion for stay of mandate under Federal Rule of Appellate Procedure 41(b) and Ninth Circuit Rule 41-1. The Ninth Circuit Court of Appeals on January 18, 1996 issued its order granting the motion for stay of mandate pending the filing of a petition for writ of certiorari to this Court, provided that such petition is filed within 30 days of the order granting the motion for stay of mandate (App-139).

III. The Enactment of the Private Securities Litigation Reform Act of 1995

Recent major federal legislation is pertinent to the issues raised in this petition. On December 22, 1995, the United States Congress, overriding the President's veto, enacted into law the Private Securities Litigation Reform Act of 1995, Public Law 104-67 (the "Act"). The provisions of the Act are reproduced at App-140.

Among other matters, the Act codifies applicable pleading standards in federal securities fraud actions, expressly requiring that

> [i]n any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

(App-160-161.) This is the very interpretation of Rule 9(b) which the Ninth Circuit Court of Appeals rejected both in

its *en banc GlenFed* decision, and in its reversal of the district court's order dismissing the present case with prejudice.

Another significant provision of the Act is its requirement that a discovery stay take effect upon the filing of a motion to dismiss a federal securities fraud action. (App-161.) The Act thus expressly approves the district court's course of action staying specified discovery in this case pending the determination of defendants' motion to dismiss.[8]

Notwithstanding these and other salutary provisions of the Act, this recent legislation does not provide any relief to petitioners (or to parties-defendant in most other pending federal securities fraud actions) because the Act at Section 108 provides that "[t]he amendments made by this title shall not affect or apply to any private action arising under title I of the Securities Exchange Act of 1934 or title I of the Securities Act of 1933, commenced before and pending on the [December 22, 1995] date of enactment of this Act." (App-183.)

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[8] The district court's discretionary stay of pre-motion-to-dismiss discovery was warranted by case law. *See, e.g., Jarvis v. Regan*, 833 F.2d 149, 155 (9th Cir. 1987); *In re Wyse Technology Sec. Litig.*, 744 F.Supp. 207, 210 (N.D. Cal. 1990); *Denny v. Barber*, 73 F.R.D. 6, 10 (S.D.N.Y. 1977), *aff'd*, 576 F.2d 465 (2d Cir. 1978); *Avnet, Inc. v. American Motorists Insurance Co.*, 115 F.R.D. 588, 592 (S.D.N.Y. 1987).

REASONS FOR GRANTING THE WRIT

I. This Court Should Grant the Writ to Resolve a Direct Conflict of Authority Among Different Circuit Courts of Appeals Concerning the Proper Interpretation and Application of Federal Rule of Civil Procedure 9(b) in Securities Fraud Actions.

This case presents important questions concerning the interpretation and proper application of Rule 9(b) to securities fraud lawsuits, particularly suits filed on the heels of a corporation's announcement of disappointing financial news and an attendant drop in the company's stock trading price. In this case, the Ninth Circuit Court of Appeals, reversing the district court, permitted such a securities fraud lawsuit to survive dismissal.

In reaching this result, the Ninth Circuit Court of Appeals applied its own peculiar *GlenFed* Rule 9(b) standard. This new *GlenFed* standard – unlike the Rule 9(b) standard adopted by other circuit courts of appeals, and the legislative standard enacted by the Private Securities Litigation Reform Act of 1995 – does not require that plaintiffs plead sufficient facts to raise an inference or a strong inference of fraudulent intent.

The reversal of the district court's order of dismissal in this case exemplifies the clear conflict of authority among different circuit courts of appeals concerning the appropriate interpretation and application of Rule 9(b) to securities fraud actions. As the opinion in the present case illustrates, the Ninth Circuit's aberrational "explanation of falsity" pleading standard requires a different mode of judicial analysis, and can lead to different results in particular cases, than the "inference of fraud" pleading

standards adhered to by other circuit courts of appeals – including the First, Second and Seventh Circuits.[9] As stated in United States Senate Report No. 104-98, *reprinted in* 1696 Federal Securities Law Reports (CCH) 71, 79 (¶ 402 – Jan. 10, 1996), the Second Circuit Court of Appeals' "strong inference" of fraud pleading standard – which the Ninth Circuit explicitly rejected in its *en banc GlenFed* decision – is "regarded as the most stringent pleading standard" (citing testimony of Arthur Levitt, Chairman of the U.S. Securities and Exchange Commission).

The Ninth Circuit Court of Appeals in its November 20, 1995 opinion in this case expressly acknowledged that a district court adjudicating a motion to dismiss appropriately may consider the full text of documents referenced or quoted in the complaint, App-4, n.1. Nevertheless, the Ninth Circuit panel in its opinion conclusorily reversed the district court, without providing a specific explanation where or how the panel disagreed with the district court's careful and critical analysis of plaintiffs' allegations vis-à-vis the actual disclosure documents sued upon. Instead, the Ninth Circuit panel relied on a purported change in The Price Company's expansion plans over a three-month period as "circumstantial evidence that the [earlier] optimistic statements were false when made." App-13. This reasoning ignores the reality

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[9] *See* cases cited at note 7 *supra*. Significantly, as demonstrated above, the Ninth Circuit's "explanation of falsity" standard was enunciated by an *en banc* panel only after the district court, applying previous case law, had dismissed the present action with prejudice.

of the business world, in which the competitive environment changes rapidly and companies must adapt quickly to changing business conditions. The Ninth Circuit panel in this case has transformed this business reality – which sooner or later affects every company – into evidence of fraud sufficient to satisfy the Ninth Circuit's *GlenFed* Rule 9(b) standard.[10] Given that the typical securities fraud case follows a business reversal, and the drop in stock price that usually attends the announcement of a change in a company's plans, it is hard to imagine a situation that would not satisfy the panel's test.

In addition, the panel opinion in this case held that, because two corporate officers sold some of their stock, *a fortiori* they "knew or had reason to know that the financial condition of the Company was deteriorating." (App-14.) In most major companies, incentive stock options typically are a major part of the overall executive compensation package. It will be the rare company in which plaintiffs cannot find some stock sales by officers every quarter. Nonetheless, the Ninth Circuit opinion in this case enables plaintiffs to posit such isolated stock sales as "circumstantial evidence" that prior optimistic statements were false when made – even though such sales say nothing about whether or not a particular statement was true. This illogical inference, which under the

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[10] *But see Arazie v. Mullane*, 2 F.3d 1456, 1467-1468 (7th Cir. 1993) ("[T]emporal proximity between positive statements stressing affirmed strengths and announcements of poor economic performance do not create an inference that the earlier statements were fraudulent") (affirming dismissal without leave to amend). *See also* note 11 *infra*.

panel opinion in this case satisfies the *GlenFed* Rule 9(b) standard, should be disavowed by this Court.

The district court in this case, it is respectfully submitted, applied a more rational and cogent Rule 9(b) analysis than the "explanation of falsity" standard later fashioned by the Ninth Circuit Court of Appeals.[11] Because a clear conflict among different United States courts of appeals is presented as to the interpretation and requirements of Rule 9(b), review by writ of certiorari of these important issues is appropriate under Supreme Court Rule 10.1(a).

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[11] The district court's analytical approach and order of dismissal in this case accord with numerous authorities, including, *inter alia: DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990), *cert. denied*, 498 U.S. 941 (1990) (affirming dismissal and observing that plaintiffs had failed to point to facts indicating that "the differences between . . . two statements of the firm's condition" at different times was due to fraud); *Greenstone v. Cambex Corp.*, 975 F.2d 22, 25-27 (1st Cir. 1992) (Breyer, J.) ("To permit a securities fraud complaint to state, without more, that the corporation's executives 'knew' in 1991 about the likely decline in 1992 sales would sanction what Judge Friendly called 'fraud by hindsight,' a practice that courts have not allowed"); *Raab v. General Physics Corporation*, 4 F.3d 286, 291 (4th Cir. 1993) ("Every prediction of success that fails to materialize cannot create on that account an action for securities fraud") (affirming dismissal with prejudice); *Hershfang v. Citicorp*, 767 F.Supp. 1251, 1259 (S.D.N.Y. 1991) ("Read as a whole, the complaint creates the strong impression that when Citicorp announced a cut in dividends, plaintiff's counsel simply stepped to the nearest computer console, conducted a global Nexis search, pressed the 'Print' button, and filed the product as their complaint") (dismissing securities fraud action filed two days after dividend decline announcement).

II. This Court Should Grant the Writ to Establish a Uniform Pleading Standard Governing the Numerous Securities Fraud Actions Pending in the Federal Court System Which Are Not Subject to the Private Securities Litigation Reform Act of 1995.

The Federal Rules of Civil Procedure apply to federal civil actions filed in all 50 states and all 11 federal judicial circuits. Likewise, securities fraud actions (many of them putative class actions involving the threat of huge liability and the certainty of high litigation expenses) are pending in United States district courts all across the country. Frequently, and as petitioners respectfully submit is true in this case, such cases are based on little more than a drop in the defendant company's stock trading price following the timely and good faith reporting of negative or disappointing financial information. It is just and desirable that like cases be treated alike, and that the provisions of Rule 9(b) be interpreted and applied consistently by all federal courts called upon to adjudicate motions to dismiss securities fraud lawsuits such as the present action.

Petitioners therefore respectfully submit that this case not only involves a conflict among decisions of different circuit courts of appeals, but also "involves an important federal question that has not been but should be settled by the Supreme Court." Supreme Court Rule 10.1(c). Although the December 22, 1995 enactment into law of the Private Securities Litigation Reform Act of 1995, Public Law 104-67, will foster national uniformity as to applicable pleading standards in federal securities fraud actions commenced from December 22, 1995 forward, hundreds of securities fraud actions were pending

in the federal court system before the Act became effective.[12] These actions remain subject to the divergent interpretations of Rule 9(b) by the Ninth Circuit Court of Appeals, on the one hand, and other circuit courts of appeals, on the other hand.

It is anomalous and unjust that this case, which exemplifies the reasons Congress recently enacted sweeping reforms with respect to federal securities litigation, should be consigned to years of expensive discovery and further litigation under the aberrational Rule 9(b) standard newly minted by the Ninth Circuit.[13] Manifestly,

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[12] Between 300 and 400 securities fraud lawsuits are filed in the U.S. each year (Financial Times Ltd. Financial Regulation Report, July 1995, *available in* LEXIS, Nexis Library, CURNWS File). Furthermore, according to H.R. Rep. No. 104-50 (Part 1), *reprinted in* 1696 Federal Securities Law Reports (CCH) 143, 144 (¶ 601 – Jan. 10, 1996), which forms part of the legislative history of the Private Securities Litigation Reform Act of 1995, the firm of Milberg, Weiss, Bershad, Hynes & Lerach (respondents' lead counsel in this case) *alone* recently "filed 229 different suits over forty-four months – one every 4.2 business days."

[13] Indeed, the facts of this case mirror the facts of the "typical case" as summarized in H.R. Rep. No. 104-50 (Part 1), *supra*:

> Whenever there is any sudden change in stock price, there is, by definition some surprise (e.g., a disappointing earnings announcement or an adverse product development). Securities class action lawyers can then file a complaint (frequently many are filed immediately after any sudden price drop) claiming that some group of defendants "knew or should have known" about the negative information and disclosed it earlier (footnote omitted).
>
> Officers, directors, accountants, and consultants are also named as defendants. Damages sought by

this case would not survive dismissal at the pleading stage under the recently enacted amendments to the federal securities laws, and *did not* survive dismissal under the mainstream Rule 9(b) jurisprudence adhered to by the district court, which dismissed this case with prejudice after plaintiffs demonstrated an inability to cure the defects of their pleading through further amendment. (App-72.)

This Court repeatedly has expressed concerns about the *in terrorem* nature of facile federal securities fraud complaints which survive the pleading stage and inflict protracted, disruptive and hugely expensive litigation upon corporations and their officers. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1117 (1991); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975). By reviewing and rejecting the Ninth Circuit Court of Appeals' permissive and unique "explanation of falsity" Rule 9(b) standard, this Court would assure that the sufficiency of the fraud allegations made in this case – and in numerous other federal securities fraud actions

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> plaintiffs – on behalf of anyone who bought the company's stock prior to the earnings announcement – amount to hundreds of millions of dollars. The plaintiffs who bring the suit typically hold only a handful of shares in the company. . . .
>
> In the typical case, after some legal skirmishing, the court refuses to dismiss the complaints and discovery begins. With relatively little specific evidence other than a drop in stock price, the plaintiffs have succeeded in filing a lawsuit, triggering the costly discovery process, and imposing massive costs on the defendant who possesses the bulk of the relevant information.

not governed by the recent legislative developments – would be determined with reference to a uniform, sensible and rigorous Rule 9(b) pleading standard.

CONCLUSION

For all the foregoing reasons, petitioners The Price Company, Robert E. Price, Dennis R. Zook and Theodore Wallace respectfully request that this Court grant a Writ of Certiorari to review the decision of the Ninth Circuit Court of Appeals, which reversed the district court's judgment of dismissal in this case.

Respectfully submitted,

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February 16, 1996

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MAX FECHT, On behalf of himself and all others similarly situated; ERROL MARCUS; NORMAN COOPER; HAMILTON J. SAH, et al., *Plaintiffs-Appellants,* v. THE PRICE COMPANY; ROBERT W. PRICE; DENNIS R. ZOOK; THEODORE WALLACE, et al., *Defendants-Appellees.*	No. 93-55541 D.C. No. CV-92-00497-RMB OPINION

Appeal from the United States District Court
for the Southern District of California
Rudi M. Brewster, District Judge, Presiding

Argued and Submitted October 4, 1994
Submission Withdrawn October 20, 1994
Resubmitted January 3, 1995
Pasadena, California

Filed November 20, 1995

Before: Dorothy W. Nelson, William A. Norris, and Danny J. Boggs,* Circuit Judges.

Opinion by Judge Norris

---

* Honorable Danny J. Boggs, United States Court of Appeals for the Sixth Circuit, sitting by designation.

COUNSEL

Eric A. Isaacson & Dennis Stewart, MILBERG, WEISS, BERSHAD, HYNES & LERACH, San Diego, California, for the plaintiffs-appellants.

James P. Delphey, SELTZER, CAPLAN, WILKINS & McMAHON, San Diego, California, for the defendants-appellees.

OPINION

NORRIS, Circuit Judge:

Plaintiffs appeal the district court's dismissal of their securities fraud action on the ground that it failed to meet the requirements of Fed. R. Civ. P. 12(b)(6) and 9(b). We review the district court's dismissal *de novo*, *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1439-40 (9th Cir. 1987), and reverse and remand to the district court.

I

Over the course of two days in early April, 1992, the price of the stock of The Price Company ("Company") fell from $45 per share to $32 per share. The decline occurred immediately after the Company announced a drop in its net income for the first quarter of 1992, the first year-to-year earnings decline in the Company's history. On the day following the announcement, plaintiffs filed this class action seeking damages for violations of §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 promulgated by the Securities and

Exchange Commission ("SEC"), and various California laws prohibiting fraud.

In their second amended complaint ("Complaint"), plaintiffs allege that prior to the April 2 announcement, the Company and three of its top-ranking officers intentionally misrepresented the financial condition of the Company, in particular its expansion program's prospects for enhancing the Company's earnings. The Complaint cites various public statements – either prepared by the Company itself (Shareholder Reports, Form 10-Qs, Form 10-K, newspaper interviews) or prepared by securities analysts with the approval and guidance of the Company – and alleges that these statements created the impression that the Company was successfully expanding its retail warehouse operations when, in fact, the Company's expansion program was failing. Complaint, ¶¶ 27-56, 59. The Complaint asserts that these statements were thus "false and misleading and operated to inflate the market price of Price Company's publicly traded securities." Complaint ¶ 25. The Complaint also alleges that the Company's SEC reports were "false and misleading because of their omission of the material adverse information" known to the defendants regarding the expansion program. Complaint ¶ 26. The district court concluded that the allegations of 10b-5 violations and of fraud were insufficient and dismissed the Complaint pursuant to Fed. R. Civ. P. 12(b)(6) and 9(b) without leave to amend.

II

The district court held that the Complaint failed to plead adequately the first element of a 10b-5 cause of action – that the defendant made materially misleading statements or omissions, *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). After examining the full texts of the source documents cited in the Complaint,[1] the district court concluded as a matter of law that (1) the public statements were not misleading because they included cautionary or guarded language, and (2) the defendants' failure to disclose the losses sustained by the warehouses opened in the expansion program was not a *material* omission because it is the profitability of the Company as

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[1] Defendants attached to their motion to dismiss the full text of the Company's corporate disclosure documents and the securities analysts' reports quoted in the Complaint. Plaintiffs argue that because the district court considered the full text of these documents – many portions of which were not pleaded in the Complaint – defendants' motion to dismiss should have been converted into a motion for summary judgment, affording plaintiffs the opportunity to present additional evidentiary materials. This argument is foreclosed by *Branch v. Tunnell*, 14 F.3d 449 (9th Cir.), *cert. denied*, 114 S. Ct. 2704 (1994), in which we stated:

> As it makes sense and comports with existing practice, we hold that documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading, may be considered in ruling on a Rule 12(b)(6) motion to dismiss. Such consideration does "not convert the motion to dismiss into a motion for summary judgment."

Id. at 454 (quoting *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 879 n. 3 (1st Cir. 1991)).

a whole, not any one particular aspect of the Company's operations, that is significant. We disagree that the question whether an omission is material or a statement is misleading can be determined in this case as a matter of law.

Whether an omission is "material" is a determination that "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976); *accord United States v. Gaudin*, 115 S. Ct. 2310, 2314 (1995) (materiality is an "application-of-legal-standard-to-fact sort of question . . . [that] has typically been resolved by juries"); *Kaplan v. Rose*, 49 F.3d 1363, 1375 (9th Cir. 1994) ("materiality" is a "fact-specific issue[ ] which should ordinarily be left to the trier of fact"), *cert. denied*, 116 S. Ct. 58 (1995). Similarly, whether a public statement is misleading, or whether adverse facts were adequately disclosed is a mixed question to be decided by the trier or [sic] fact. *Durning v. First Boston Corp.*, 815 F.2d 1265, 1268 (9th Cir.) (quoting *TSC Indus.*, 426 U.S. at 450, and stating that "[l]ike materiality, adequacy of disclosure is normally a jury question"), *cert. denied*, 484 U.S. 944 (1987). Therefore, only if the adequacy of the disclosure or the materiality of the statement is "so obvious that reasonable minds [could] not differ" are these issues "appropriately resolved as a matter of law." *Durning*, 815 F.2d at 1268; *accord TSC Indus.*, 426 U.S. at 450.

The cautionary statements cited by the district court, when considered against the backdrop of the allegations

set forth in Paragraph 59 of the Complaint ("Price Company's Undisclosed Adverse Information")[2] – allegations which at this stage we must accept as true, *Durning*, 815 F.2d at 1267, – do not "so obviously" render the challenged public documents not misleading as to permit the adequacy of the disclosure to be determined as a matter of law. For example, in one Report to Shareholders, the Company states that it "anticipates a continuation of its accelerated expansion schedule. . . . " Complaint ¶ 27. This statement, even in the context of the Company's acknowledgment that it "feel[s] a little more optimistic about our near-term future than we did at the end of the last quarter," which the district court relied on as an admission that the Company had not been too happy with the earlier sales, could reasonably be interpreted as conveying a level of confidence in the continued viability of the expansion program not borne out by the adverse facts allegedly known to the defendants. In another Report to Shareholders, the Company predicted an "overall improvement in the sales trend due [in part] to the

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[2] As alleged in Paragraph 59 of the Complaint, the following material information was known, but withheld, by the defendants: the Company was experiencing consistent losses in almost all of its new stores; initial sales volumes in the new stores were well below the levels usually experienced upon new store openings and well below the levels necessary to achieve profitable operations; the East Coast and Canadian stores were performing worse than expected; the expansion program was being implemented too rapidly and without adequate feasibility studies; the expansion program was severely impacting the Company's profitability; and no reasonable basis existed for the bullish forecasts concerning the expansion program.

large number (24) of new Price Clubs." Complaint ¶ 32. This statement could also reasonably be considered misleading when, as alleged by plaintiffs, most of the new stores were actually losing money. The follow-up statement relied on by the district court that "[e]arnings may not increase at as high a rate as sales because of the . . . operating costs associated with opening new Price Clubs," not only does not cure, but arguably contributes to the alleged misconception that the new stores were increasing the Company's profitability because it assumes an increase in earnings and focuses only on the rate of that increase. Thus, as these examples illustrate, the mix of information contained in the public documents issued by the Company does not clearly preclude "reasonable minds" from differing on the question of whether they included misleading statements.

Defendants attempt to support the district court's resolution of the "misleading" question as a matter of law by relying on the "bespeaks caution" doctrine. We have recognized that the "bespeaks caution" doctrine "provides a mechanism by which a court can rule as a matter of law . . . that defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud." *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413 (9th Cir. 1994) (citation omitted), *cert. denied*, 116 S. Ct. 185 & 277 (1995). However, we have also recognized that the "bespeaks caution" doctrine reflects nothing more than "the unremarkable proposition that statements must be analyzed in context." *Id.* at 1414 (quoting *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994)). In other words, the doctrine is merely a new name for a

venerable precept that does not alter the standard for deciding questions as a matter of law. The "bespeaks caution" doctrine is thus wholly consistent with our analysis that whether a statement in a public document is misleading may be determined as a matter of law only when reasonable minds could not disagree as to whether the *mix* of information in the document is misleading. Inclusion of *some* cautionary language is not enough to support a determination as a matter of law that defendants' statements were not misleading. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991) ("a misleading statement will not always lose its deceptive edge simply by joinder with others that are true. . . . "). A motion to dismiss for failure to state a claim will succeed only when the documents containing defendants' challenged statements include "*enough* cautionary language or risk disclosure," *Worlds of Wonder*, 35 F.2d at 1413 (citation omitted) (emphasis added), that "reasonable minds" could not disagree that the challenged statements were not misleading. The defendants' statements here do not meet this requirement, and invocation of the "bespeaks caution" doctrine cannot save the defendants' 12(b)(6) motion.

In sum, the Complaint sets forth public statements and omissions that reasonable jurors could find to be materially misleading. Neither Rule 12(b)(6) nor the "bespeaks caution" doctrine requires more. Therefore, the complaint alleges all the elements of a 10b-5 cause of action and, accordingly, the district court erred in dismissing the Complaint for failure to state a claim upon which relief could be granted.

III

We now turn to the second issue raised by the appeal: Does the complaint allege fraud with sufficient particularity to withstand a challenge pursuant to Fed. R. Civ. P. 9(b)?[3]

"In a securities fraud action, a pleading is sufficient under Rule 9(b) if it identifies the circumstances of the alleged fraud so that the defendant can prepare an adequate answer." *Kaplan v. Rose*, 49 F.3d at 1370. This notice requirement is satisfied by allegations of the "time, place and nature of the alleged fraudulent activities." *Walling v. Beverly Enters.*, 476 F.2d 393, 397 (9th Cir. 1973). When a fraudulent statement is alleged, the "plaintiff must set forth what is false or misleading about [the] statement, and why it is false." *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994) (en banc).[4] In other words, the plaintiff must "set forth, as part of the circumstances

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[3] "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Fed. R. Civ. P. 9(b).

[4] With respect to scienter, the plaintiffs need "simply . . . say[ ] that scienter existed" to satisfy the requirements of Rule 9(b). *GlenFed*, 42 F.3d at 1547. Although the district court found that the Complaint's allegations of scienter were insufficient, the allegations, Complaint ¶¶ 25, 61 ("defendants knew the impression created by this conduct and these statements . . . was false and misleading . . . "; "Price Company was . . . aware that the securities analysts' reports were based on information publicly disseminated by Price Company . . . and that these reports were false and misleading . . . "), clearly meet the *GlenFed* standard.

constituting fraud, an explanation as to why the disputed statement was untrue or misleading *when made.*" *Id.* at 1549 (emphasis in original). Thus *GlenFed* requires a plaintiff to plead evidentiary facts and the court to consider what inferences these facts will support – despite the pitfalls and inefficiencies of such an analysis at the pleading stage, *id.* at 1556 (Norris, J., concurring) – and whether they are sufficient to satisfy the specificity requirement of Rule 9(b) as interpreted by *GlenFed.*

The *GlenFed* standard is most easily satisfied when there is direct evidence of fraud, i.e., "[inconsistent] facts that had existed all along and were later revealed." *Id.* at 1549. In these cases, a plaintiff may simply set forth these facts (along with allegations of time, place, and scienter) and satisfy Rule 9(b). *Id.* at 1548. Thus, a complaint alleging that the plaintiff bought a house from the defendant, that the defendant assured the plaintiff that the house was in perfect shape, and that the house was in fact built on landfill, would satisfy rule 9(b). *Id.*

A plaintiff may also satisfy Rule 9(b) with allegations of circumstantial evidence if the circumstantial evidence alleged explains how and why the statement was misleading when made. *See id.* at 1549. Thus, when there is an intervening event which might account for the conflict between the alleged misrepresentation and the current state of facts, for instance a general decline in the stock market or an event internal to the company such as a revaluation of assets, a plaintiff may satisfy Rule 9(b) by alleging inconsistent contemporaneous statements indicating that the defendant knew all along that the earlier statement was false, or by showing that the conflict does not result merely from the earlier statement's being based

on a different but equally permissible business judgment. *Id.* at 1548-49.

We believe that sufficient evidentiary facts are pleaded to explain why the Company's statements were false when made and, thus, to satisfy the requirements of Rule 9(b) as interpreted by *GlenFed*. The Complaint alleges that the positive statements about the expansion program were false when made because, in truth, the new stores were losing money and the program overall was doing so poorly that it would have to be curtailed or abandoned. Complaint ¶¶ 5, 59(a)-(d). Thus plaintiffs allege facts that reveal that the statements failed to reflect the Company's true condition at the time the statements were made. A plaintiff may "draw on contemporaneous statements or conditions" to demonstrate why statements were false when made. *Id.* at 1549; *see also In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 930 (9th Cir. 1993) ("[s]tatements of . . . opinions, or beliefs . . . are actionable under § 10(b), if . . . there is [no] reasonable basis for that belief. . . . ") (citation omitted), *cert. denied*, 115 S. Ct. 295 (1994). More particularly, plaintiffs cite specific problems with the expansion program: unsatisfactory initial sales volumes at the new stores[5] and losses at specifically identified stores.[6] For purposes of Rule 9(b), allegations of specific

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[5] Paragraph 59(a) of the Complaint alleges "That initial sales volumes of Price Company's stores newly opened during [the] Class Period were below levels usually experienced upon new store openings and levels necessary for the stores to achieve profitable operations. . . . "

[6] Paragraph 59(c) of the Complaint alleges: "That recent store openings in Maple Shade, New Jersey, Denver, Colorado, Vancouver, British Columbia, New Britain, Connecticut and

problems undermining a defendant's optimistic claims suffice to explain *how* the claims are false. *See GlenFed*, 42 F.3d at 1551 ("[P]laintiffs have pointed to specific problems which they allege undermined defendants' optimistic claims: aged appraisals which concealed risk of loss; inaccuracies in the commercial real estate portfolio data base; inadequate controls on single-borrower loans. Thus this case . . . is distinguishable from those cases . . . in which plaintiffs stated simply that defendants' public statements were false, without explaining *how* they were false.") (emphasis in original); *Wells Fargo*, 12 F.3d at 926-27 (Rule 9(b) satisfied by allegations that bank understated its non-performing assets and reserves because it failed to account for defaults and doubtful collectibility of specifically identified problem loans).

In addition, the Complaint pleads facts that show that the decision to terminate the expansion program was made very shortly after the optimistic statements were made, i.e., the decision to terminate the program was announced on April 2, 1992, even though the Company was issuing positive statements about the program on January 14-16, 1992. Complaint ¶¶ 53-56. This shortness

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Seekonk, Massachusetts were proceeding poorly and most of these units were losing money." Paragraph 59(f) of the Complaint alleges: "That, at least for the near term, Price Company faced a major threat of eroding profits and declining margins because of the size of the losses being suffered at Price Company's newly opened stores, especially in Denver, Colorado and Vancouver, B.C." Paragraph 59(k) of the Complaint alleges: "That Price Company's new stores in Denver, Colorado and Vancouver, B.C. were performing very poorly and suffering significant losses that were adversely affecting Price Company's overall results."

of time is circumstantial evidence that the optimistic statements were false when made. We give this circumstantial evidence more weight in view of the absence of any indication of an intervening catastrophic event. *See GlenFed*, 42 F.3d at 1549 (when no catastrophic event intervened between the time of the complained-of statements and the revelation of the truth, the particularity required by Rule 9(b) may be supplied by pointing to later inconsistent statements or conditions).

The weight of these averments also increases when they are read in conjunction with the Complaint's allegations that the optimistic statements permitted the successful offering of 73,000 shares of The Price REIT, which raised some $71 million for the Company. Complaint ¶¶ 36-42. Moreover, the Complaint alleges that two high-ranking company managers were making insider sales at inflated prices of Company stock during the period in which the optimistic statements were being issued. Complaint ¶¶ 13(b)-(c), 17, 68. The Complaint alleges that the Company's Chief Operating Officer for the West Coast and Chief Operating Officer for the Company's East Coast operations – two top executives involved in the expansion program – sold respectively 12,000 and 18,000 shares of Company stock for a total of $1.6 million during the period in which the allegedly false statements were being made. The Complaint pleads evidence that these sales represented significant retrenchments of the Company executives' own positions in the Company's stock: The sales by the COO for the West Coast involved all of the Company stock he had acquired by option during the period in which the optimistic statements were being made; the sales by the COO for the East Coast halved his

total holdings in the Company. These sales are circumstantial evidence that the defendants knew or had reason to know that the financial condition of the Company was deteriorating well before they disclosed the problems with the expansion program. *See GlenFed*, 42 F.3d at 1550 (allegations of contemporaneous statements indicating difficulties facing sale of real estate subsidiary explain why public statements that company expected no loss from such a sale were false when made, thus satisfying Rule 9(b)); *Wells Fargo*, 12 F.3d at 930 ("statements of . . . opinions, or beliefs . . . are actionable under § 10(b), if . . . the statement is [not] genuinely believed, [or] . . . the speaker is . . . aware of any undisclosed facts tending to seriously undermine the accuracy of the statement") (citation omitted).

These allegations satisfy *GlenFed*'s requirement that the plaintiffs "set forth what is false or misleading about [the] statement[s], and why it is false." *Id.* at 1548. The Complaint thus states the circumstances constituting the alleged fraud with the particularity Rule 9(b) requires. We therefore hold that the district court erred when it dismissed the Complaint for failure to comply with Rule 9(b).

REVERSED and REMANDED to the district court for further proceedings consistent with this opinion.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO and JOSEPH LASENSKY, On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, v. THE PRICE COMPANY, ROBERT PRICE, DENNIS ZOOK, and TED WALLACE, Defendants.	CASE NO. 92-497-B (BTM) ORDER STAYING DISCOVERY PENDING DETERMINATION OF DEFENDANTS' MOTION TO DISMISS (Filed July 9, 1992)

Defendants' Motion to Stay Discovery Commenced by Plaintiffs came on regularly for hearing on June 11, 1992, at 9:30 a.m. in Courtroom B of the above-referenced Court, the Honorable Barry Ted Moskowitz, Judge Magistrate presiding. Plaintiffs appeared by their counsel Dennis Stewart of Milberg Weiss Bershad Specthrie & Lerach and Howard Finkelstein of Finkelstein & Associates; defendants appeared by their counsel Gerald L. McMahon and James P. Delphey of Seltzer Caplan Wilkins & McMahon; and non-party Ernst & Young appeared by its counsel Joel Bonner.

Upon consideration of the briefs and other documents filed and the arguments of counsel, and for cause shown, it is HEREBY ORDERED that defendants' Motion

to Stay Discovery Commenced by Plaintiffs is GRANTED on the following terms and conditions:

1. All discovery sought by: (1) plaintiffs' First Request to Defendants for the Production of Documents (dated April 22, 1992), (2) plaintiffs' document production subpoena to Ernst & Young (dated April 22, 1992), (3) plaintiffs' deposition subpoena to third-party witness Chris Vroom (dated May 19, 1992), and (4) any other notices of deposition or other discovery requests not served by plaintiffs as of June 10, 1992, is STAYED until the Court rules on defendants' pending motion to dismiss, which is scheduled for hearing on September 21, 1992.

2. The discovery of documents sought by plaintiffs' subpoenas (dated April 27, 1992) to Merrill Lynch Pierce Fenner & Smith; The First Boston Corp.; Dean Witter Financial Services, Inc.; Alex. Brown & Sons, Inc.; Wheat First Securities; Wertheim Schroeder & Co., Inc.; Kidder Peabody & Co., Inc. and Chris Vroom of Alex. Brown & Sons dated May 19, 1992 (as to the production of documents called for therein) is not subject to the stay as set forth in paragraph 1 above.

3. The discovery sought by the pending interrogatories and requests for production of documents served by defendants upon plaintiffs (dated May 12, 1992) is also subject to the stay as set forth in paragraph 1 above.

4. No party has any present obligation to respond to any discovery notice or request stayed by this Order. Counsel for plaintiffs and defendants nonetheless are ordered to meet personally by July 30, 1992 for the purposes of (1) discussing pending discovery requests and

pending objections thereto and (2) attempting in good faith to reach agreements which will enable discovery to proceed expeditiously in the event defendants' pending motion to dismiss is denied by the Court and the stay of discovery ordered herein is lifted.

5. Nothing in this order shall prevent any party from (1) seeking to set a discovery conference or hearings on discovery motion(s) on dates after September 21, 1992; (2) applying for partial relief from the stay imposed by this order, based on a specific showing of good cause and that prejudice will result if particular discovery is not allowed to proceed; or (3) propounding additional discovery for response subsequent to September 21, 1992.

Dated: 7/8, 1992

/s/ Barry Ted Moskowitz
BARRY TED MOSKOWITZ
UNITED STATES
MAGISTRATE

APPROVED AS TO FORM:

MILBERG, WEISS, BERSHAD
SPECHTRIE & LERACH

By: /s/ Dennis Stewart
William S. Lerach, Esq.
Dennis Stewart, Esq.
Attorneys for Plaintiffs

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By: /s/ Howard Finkelstein
Howard Finkelstein, Esq.
Attorneys for Plaintiffs

[*signatures cont'd on next page*]

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Gerald L. McMahon, Esq.
James P. Delphey, Esq.
Attorneys for Defendants

/s/ Joel E. Bonner
Joel Bonner, Esq.
Attorney for Ernst & Young

ORDER STAYING DISCOVERY
PENDING DETERMINATION OF
DEFENDANTS' MOTION TO DISMISS
RE: Fecht v. The Price Company
Case No. 92-497-B (BTM)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO and JOSEPH LASENSKY, On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, v. THE PRICE COMPANY, ROBERT PRICE, DENNIS ZOOK, and TED WALLACE, Defendants.	CASE NO. 92-497-B (BTM) ORDER AFFIRMING MAGISTRATE'S ORDER STAYING DISCOVERY PENDING DETERMINATION OF DEFENDANTS' MOTION TO DISMISS (Filed Aug. 12, 1992)

Plaintiffs' Objections under FRCP 72(a) to the Order Staying Discovery Pending Determination of Defendants' Motion to Dismiss (filed July 9, 1992 by United States Magistrate Judge Barry Ted Moskowitz) came on regularly for hearing on July 21, 1992, at 3:00 p.m. in Courtroom 2 of the above-referenced Court, the Honorable Rudi M. Brewster, United States District Judge, presiding. Plaintiffs appeared by their counsel William S. Lerach and Dennis Stewart of Milberg Weiss Bershad Specthrie & Lerach; defendants appeared by their counsel Gerald L. McMahon and James P. Delphey of Seltzer Caplan Wilkins & McMahon; and non-party Ernst & Young appeared by its counsel Joel Bonner.

Upon consideration of the briefs filed and the arguments of counsel, and for cause shown, it is HEREBY

ORDERED that the Order Staying Discovery Pending Determination of Defendants' Motion to Dismiss ("the Stay Order") is AFFIRMED and plaintiffs' Objections to the Stay Order are OVERRULED. With respect to the concern expressed by plaintiffs' counsel about potential loss or destruction of documents by non-parties during the period of the stay, the Court rules that the Stay Order as affirmed herein does not prohibit service of discovery requests during the stay period for response after September 21, 1992.

Dated: AUG 11 1992, 1992 /s/ Rudi M. Brewster
RUDI M. BREWSTER
UNITED STATES DISTRICT JUDGE

APPROVED AS TO FORM:

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By: /s/ James P. Delphey
Gerald L. McMahon, Esq.
James P. Delphey, Esq.
Attorneys for Defendants

[*signatures cont'd on next page*]

/s/ Joel Bonner
Joel Bonner, Esq.
Attorney for Ernst & Young

ORDER AFFIRMING MAGISTRATE'S
ORDER STAYING DISCOVERY
PENDING DETERMINATION OF
DEFENDANTS' MOTION TO DISMISS
RE: Fecht v. The Price Company
Case No. 92-497-B (BTM)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, et al., Plaintiffs, vs. THE PRICE CO., et al., Defendants.	)	Case No. 92-0497-B Civil

TRANSCRIPT OF HEARING ON MOTION TO DISMISS
Taken in San Diego, California
September 21, 1992

BEFORE THE HONORABLE RUDI M. BREWSTER

Echo Reporting
7046 Enders Avenue
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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, et al., Plaintiffs, vs. THE PRICE CO., et al., Defendants.	)	Case No. 92-0497-B San Diego, California Monday, September 21, 1992 10:30 a.m.

TRANSCRIPT OF HEARING ON MOTION TO DISMISS
BEFORE THE HONORABLE RUDI M. BREWSTER
UNITED STATES DISTRICT JUDGE

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[p. 1] SAN DIEGO, CALIFORNIA MONDAY, SEPTEMBER 21, 1992 10:30 A.M.

(Call to order of the Court.)

MR. McMAHON: Good morning, your Honor. Gerald McMahon and James Delphey of Seltzer, Caplan, Wilkins & McMahon for Defendants and moving parties.

MR. STEWART: Good morning, your Honor. Dennis Stewart of Milberg Weiss Bershad Specthrie & Lerach on behalf of the Plaintiff.

THE COURT: I'm sorry, your last name again?

MR. STEWART: Stewart.

THE COURT: Stewart. Dennis Stewart. S-T –

MR. STEWART: E-W.

MR. FINKELSTEIN: Howard Finkelstein of Finkelstein Associates on behalf of one of the Plaintiffs, Joseph Lisinsky (phonetic).

THE COURT: Good morning, Counsel. I have reviewed the voluminous file. It – it's an interesting case.

The first complaint, as I understand it, was filed on April 2, 1992. Is that right?

MR. STEWART: That's correct, your Honor.

THE COURT: And the second quarter report which precipitated this lawsuit was released on April 2, 1992?

MR. STEWART: I believe you're – I think the second quarterly report came out on the 2nd –

[p. 2] THE COURT: You guys are about as fast as a speeding bullet. How in the world can you file a multi million-dollar class action securities case 24 hours after a downturn second quarterly report on releases filed – I just noticed at the beginning – I thought, wow, I never had a lawyer work that fast in my court in my life.

MR. STEWART: Well, your Honor, first of all, the complaint is not filed simply on the fact that there were greatly reduced earnings in the second quarter of fiscal '92.

There's also the content of the announcement which was so at variance with what the company was saying, what analysts were saying about what was going on in the company in the entire year proceeding, and that is that the company was following successfully accelerated expansion program which was essentially going to take what had been flat performance and in fiscal '92 and fiscal '93 was going to result in a very enhanced earnings turnaround.

And one looks very, very carefully at what those statements were for the year prior –

THE COURT: Well, are you telling me that clients walked into your shop sometime on the 2nd of April and laid out this case to you and you filed within 24 hours on it, or were you working on this case for months? And if you were, how did you get it to be so prescient that you could foresee [p. 3] that this report would come out on the 2nd?

MR. STEWART: I personally can't answer all those questions, your Honor, because I was not –

THE COURT: Can you answer any of them?

MR. STEWART: Yes, but I was not the attorney drafting the complaint, but what I can tell the Court is that there is a great wealth of information that's publicly available about the company, if one has the wherewithal to be able to find it in a hurry, and that is part of the investigation that preceded the filing of the complaint.

THE COURT: It just looks Pavlovian to me. (Pause.)

MR. STEWART: I don't know how to respond to that, your Honor.

All I can say is that a diligent investigation was done based on the wealth of information that was available about the company and the complaint was filed.

THE COURT: Allegations that they made improper site investigations for all these warehouses – how in the world can you investigate facts that would support that kind of an accusation in 24 hours?

All over the country – I mean, at the time they've got about 10 or 12 or 14 or 16 warehouses – you know, in the

design stage and all that, and the Plaintiffs can allege that the Defendants made an inadequate site [p. 4] location investigation on all those sites?

MR. STEWART: I'm not sure that there's an allegation that – they made inadequate site locations.

THE COURT: Oh, let me assure you, sir, there is.

MR. STEWART: What is being –

THE COURT: I'm quoting from the first amended complaint.

MR. STEWART: What is being – (Pause to confer.)

MR. STEWART: The first amended complaint, your Honor, was filed I think a good three weeks after the initial complaint.

THE COURT: Are you saying it's not in the original complaint?

MR. STEWART: I wouldn't say that off the top of my head, your Honor. I'm not sure it is.

THE COURT: Did you draft the complaint?

MR. STEWART: I did not.

THE COURT: What's your position in the case?

MR. STEWART: I am sort of second partner on the case. The complaint was drafted by Mr. Lerach, I believe. (Pause.)

THE COURT: Well, it's too bad he's not here. Another thing that – just reacting to the complaint. I read

this first amended complaint which is fairly [p. 5] voluminous – 53 pages or so. You know what it reads like? It reads like a negligence case. Allegations that they undertook the expansion program too rapidly, that the new stores in Denver were performing poorly which adversely affected their earnings, that they accelerated warehouse expansion without adequate feasibility studies, that they weren't keeping their stores up to snuff, that they – there were about five allegations which kind of stomp on the same turf, boiling down to the expansion of their warehouse systems being apparently too fast and not thought out enough.

Inadequate reporting systems – inadequate accounting systems – inadequate management allocations – it reads kind of like a – it reads like the Democrats accusing the Republicans of not knowing what they're doing.

MR. STEWART: Well, it's not a negligence case, your Honor.

THE COURT: I'm not saying that the Democrats are right. I don't know if they're right or wrong. It may be true, but is it a securities case? Is a securities action a negligence action?

MR. STEWART: No. Negligence is not –

THE COURT: I've never thought it was. This thing reads more like a negligence case than a securities case.

[p. 6] MR. STEWART: Well, I differ with the Court on the fair reading of the complaint. The complaint states that, throughout a period of time, both through company-issued statements and through statements that

were made by analysts who were getting their information from the company – their basic information – that a basic story was being told.

THE COURT: Well, okay, but to the extent that you gave me some facts in here, and I appreciate that because, frankly, there aren't many facts in here. Really, the whole complaint is extremely conclusory, but the extent that there are any facts in here – the facts appear to me to be: number one, apparently truthful; number two, conservative; and number three, somewhat guarded.

And then the third parties is where you put about some big chunk of your emphasis in your complaint. That's people that are hearing these conservative, truthful, objective statements being released by the company and they're drawing great comfort in that – at least the ones that you quoted drew a lot of comfort in that and started recommending "buy" and even "strong buy" recommendations to their people.

But what I don't see in the complaint is any allegation of facts which: (a) were adverse to the company's optimism; (b) were known by the company; and (c) were concealed by the company; and (d) replaced with untrue, [p. 7] rosy facts.

Now, I looked through here pretty carefully, and every time you quote the company, they issue a report saying, "We got two cents a share more earnings last quarter."

Well, you don't allege that they didn't. I mean, there's no allegation that what they said was untrue.

MR. STEWART: That's correct.

THE COURT: But – so quarter after quarter, they come in and they say, "Although we had a little bit of a disappointing year in 1991, we're hopeful that by pursuing aggressively our warehousing program that we're going to be able to improve that picture in the future. But in the meantime, in the short term, it's going to be – it's going to be conservative, and to prove it, last quarter we made two cents a share more." Two cents on the basis of 50 cents per share isn't much – 45 to 50 cents a share. A two or three or four or five cents per share increase isn't a lot to hoot and holler about.

But nevertheless, that's what the Defendant said, and they reported their plans to aggressively market these – or build these warehouses. They entered into this real estate investment trust for the purpose of raising some more capital so they could not go into debt for it so that they could take the money and spend it on more warehouses. [p. 8] They told everybody what they were doing.

The analysts thought that was a great idea. You know, they thought, "Hey, this a great idea what they are doing because they're keeping their debt down. Don't you see? They're keeping their debt down, and that makes their balance sheet look stronger." So the analysts loved that.

But whether they love it or not, where's the falsity? Where's the – where's the violation of the Securities Act? I mean, everything in this complaint – to the extent that you quote the Price Club people, every time you quote them, you quote them as saying something factual and

you never tell me in the complaint that that's false. Not once.

And you tell me that the analysts took off on that, they were very optimistic and that, during that period, your clients bought stock – you didn't tell me when in the period they bought them. I couldn't tell whether they bought them on April 3, 1991 or December or March 31st, 1992. I don't know when they bought that stock. Nobody told me.

Frankly, I mean – I read through this complaint and I sat down and I thought about it for a minute, and I thought, to the extent that they quote the Defendants, all they do is quote the Defendants saying very conservative things, very guarded things.

[p. 9] Now, it's true the Defendants said, "We are aggressively pursuing the warehouse expansion program, and we hope that that's going to help our earnings and help the company." Is that actionable?

MR. STEWART: It is, your Honor, if there is information –

THE COURT: Why is that actionable?

MR. STEWART: Your Honor, when a company speaks to the public, when it speaks to analysts, when they know that information is going to go out to the public, then they've got an obligation to tell the whole truth.

If they leave out information that an investor would like to know so they could make an interpretation on balanced information as to whether this warehouse

expansion program – this accelerated warehouse expansion program is actually going to work and do the things that the analyst is saying it will do and that the company is implicitly saying it will do, they have to speak the whole truth.

THE COURT: I don't think the Defendants can guarantee – they can't – they never did attempt to guarantee that what they were – what their corporate plan – they laid out what their corporate plan was, and they laid it out and said, "We think this is the right thing to do, and we're going to do it, and we hope it's going to profitable for us."

[p. 10] However, they're not guaranteeing anything, and "what you guys are doing is you're taking a no-fault approach to a securities case. You guys say that you're going to do this; you better succeed 'cause if you fail we're going to sue you and you're strictly liable." Just like a fraud defect.

"If you put out this widget and it fails for any reason at all, we're going to sue you and you've got – we've got strict liability here." That's what you're really alleging: strict liability.

MR. STEWART: That is not what's in the complaint, your Honor. The issue is not whether they guaranteed that there would be success. The issue is whether they gave the public all the information from which the investment community could make a decision for itself based on all the information as to whether it would succeed.

Now, when this company reports that it's going to curtail its expansion program and it has a very significant year to prior quarter earnings –

THE COURT: Which were publicly reported –

MR. STEWART: The stock goes down 13 dollars a share on 6,000,000 shares traded in two days.

Now, what that tells any reasonable observer is that the public was learning information that was at variance with what it believed, and what it believed was [p. 11] what the company was telling it and what analysts were telling the public based on conversations with management, based on information that management was providing it with –

THE COURT: You know, Counsel, you see life in very ordered and simplistic terms. I wish I could see life that easily.

A stock goes down, earnings go down for a myriad of reasons – a myriad of reasons, and the stock market goes up and down because the market is a very complicated place.

I mean, here we are in the middle of one of the worst recessions that this country's had since the '30s. It's almost a depression. It's very bad times, and they're still earning earnings, but guarded and not very much growth, and each time they get the earnings report they pass it to the investors and you've got a bunch of – a bunch of securities analysts and stockbrokers out there, and I don't mean this in any derogatory way because some of my best friends are stockbrokers, but these people are like sharks and they feed on information like it's

chumming the water with peas. I mean, they go crazy. They build this thing – and why? Because they're in the business of selling stock. They get a commission when they sell a share of stock.

MR. STEWART: They also get a lot of grief if [p. 12] they've put out a strong buy on stock and the stock goes to that hot place in a handbasket quickly.

THE COURT: So – you know, just because stock analysts took these objective facts which are given them by the company and then they interpret them in a very optimistic vein, all of a sudden that makes the liability of the Price Company?

You don't allege any facts in here that the Price Company had information that was contrary to what they were putting out in their reports. There's no allegation of any facts in here. You make a bunch of conclusory accusations, but no facts.

MR. STEWART: They are set out at paragraph – page 7 to 8 of the brief, your Honor, which is a condensation of our memorandum – and they're set out –

THE COURT: I'm looking at the complaint.

MR. STEWART: Yes –

THE COURT: This is a 12(b)(6) motion.

MR. STEWART: I understand that, your Honor. That simply is a summary of what is set forth in paragraph 57 in the complaint.

Your Honor, one thing I think we can't lose sight of – this is a pleading motion. This is not an opportunity –

THE COURT: Absolutely. That's why I'm not [p. 13] relying on your memorandum. I'm looking for paragraph 57 'cause my primary analysis is on the complaint. Here's 57, and it's entitled, "Undisclosed avarice information." It says, "The public announcement" – and I wrote here, "by whom?" What public announcements are you referring to? Because you quote – you quote about 10 times as many public announcements by third parties as you do by Price Club. The ones by public parties are much more optimistic, much more carried away with the future of Price Club than any of the quotations that you make from Price Club sources.

So right off the bat on paragraph 57, I wrote on here – it says, "The public announcement" – I wrote here "by whom?"

MR. STEWART: Well, the problem –

THE COURT: I'm just showing you what I'm trying to read this thing – I don't know anything about the Price Club stocks and – oh, by the way, I should reveal this. I don't own any stock in Price Club, but I do shop there and I have a card. Does that make any difference?

MR. STEWART: Only in the light of your Court's tentative – no, of course, not, your Honor.

THE COURT: I mean, I had to pay for it. And it doesn't pay me any dividends, but I do shop there, but I haven't been there in three or four months.

But whenever my wife takes it upon herself to take [p. 14] me over there, I go over there and we shop, and I

usually spend about a hundred bucks, too. I don't like to go over there because I spend too much money.

But anyway, I'm not going to recuse myself because I could care less what happens to the Price Club. I'm also retired Navy and I could shop in the PX and I think I could do as well elsewhere as I do at the Price Club, so I don't care whether they live or die, so I'm not recusing myself, but I do want to make it for the record that I do have a – I guess because of Government employment, but I have a card and I can shop there.

MR. STEWART: And we don't suggest that recusal is needed.

THE COURT: At any rate, look at 57. "The public announcements" – I wrote here, "by whom?" Then it says, "Financial reports." I assume that you mean Price Club on that. "SEC files." I assume you mean Price Club on that. Then it says, "Analysts' reports." Well, clearly that's third parties' reports.

MR. STEWART: But what is alleged in the complaint, your Honor, and what will be demonstrated is that analysts get their information from the company. They don't sit around and make it up. They take it from the public statement. They take it from numerous private conversations with management which –

[p. 15] THE COURT: Well, that's fine, but you don't allege – you mentioned that, but you don't tell me what was said. You don't tell me anything that was said. You don't allege that there was one false word said by anybody related to Price Club. Not one allegation. Show me, if you will – direct me to a paragraph where you

allege that there were false representations made by anybody.

MR. STEWART: It is in this paragraph that the Court is open to right now –

THE COURT: 57? Okay, then let's –

MR. STEWART: And your Honor –

THE COURT: "Interviews" – it says "interviews".

MR. STEWART: May I just make one clarification?

THE COURT: Okay.

MR. STEWART: And that is that we need not point the Defendants or the Court to a statement that Price Club said black was white and it was really white. Well –

THE COURT: You don't?

MR. STEWART: No. If Price Club omitted –

THE COURT: I thought there was a fraud count here.

MR. STEWART: If Price Club omitted information which would render statements that they made misleading, in light of all of the circumstances, then that is actionable under Section 10(b).

[p. 16] THE COURT: Well, I agree with that.

MR. STEWART: And –

THE COURT: I agree with that.

MR. STEWART: In addition –

THE COURT: Is that – am I going to find that in 57?

MR. STEWART: Yes.

THE COURT: Well, let's look there. I'm reading on line 20 now – "Interviews" – I assume that means interviews between Price Club people and analysts or newspaper reporters or somebody.

Then it says "Articles", and I wrote, "whose?" Whose articles? And then "Shareholder reports" – I assume that that means Price Club's.

It says,

> "Specified herein were each materially false and misleading? Each of them were false and misleading in that, prior to April 2, 1992, they portrayed Price Company as a very successful company that was a leader of its industry with growing profitability whose future prospects would be and were being enhanced and which would achieve revenue and earnings growth throughout fiscal [p. 17] '92-93 as part of its successful expansion."

Well, everything that they have to point to throughout that year, until the very last month, when within 24 hours this suit was filed, was all reported. There isn't one allegation that any of those figures were dummied up. There's no allegation of different books. There's no allegation of false figures being turned out. Not one allegation of any falsities filed with the SEC.

MR. STEWART: Well –

THE COURT: Nothing.

MR. STEWART: The Court is not – either – in my view has not fairly read that paragraph or has just made a finding of fact because what this complaint alleges is that, for the reasons – on account of the information that's set out in this paragraph, that that was material information and needed to be disclosed along with the public statements which essentially set out what the company's theory was going to be, or what its business plan was.

THE COURT: Well, let's look on further. It says,

> "Those four representations were each false and misleading when made in that they concealed and failed to disclose, among other things, the following adverse information which was necessary [p. 18] to make the statements not misleading."

Now, the first one – you say that,

> "Price Club was taking a major risk and facing a major danger because management had added significant fixed overhead . . . "

and so forth. And I wrote here, "This is obvious; it was implied in what was said by Price Club," because there's no question that there's risk in building warehouses all over the – not only the country but the North American continent.

MR. STEWART: The Court there is making a finding of fact on materiality and also in evaluating the disclosures, whether that was fairly disclosed.

THE COURT: Well –

MR. STEWART: Whether the gravity of the risk, the nature and extent of the risk that they're undertaking –

THE COURT: Price Club also said in some of these statements that they recognized that new warehouses were going to incur expenses in startup. There'd be less production at first. But all of that I remember reading from the statements that were made by Price Club. They said that there is risk incumbent with expansion into warehousing. That wasn't concealed by Price Club.

I mean, to just blandly assert that they concealed all this is simply not factual. It's not even what's in [p. 19] your complaint. It doesn't even jibe with your other factual portions of your complaint – and there are some – that don't even support that.

Now, look at B. It says,

> "At least in the near term, Price Club faced a major threat of eroding profits and declining margins because of the size of the loss being suffered at Price Club's new stores especially in Denver, Colorado and Vancouver."

Well, number one, Price Club did say that the new stores aren't producing up to snuff, and they're not – they often don't 'cause they've got to get off the ground and get rolling.

MR. STEWART: Your Honor, I'm sorry to keep harping on this point, but I want to make sure it comes across. When the Court makes a comment like that, what

the Court is doing is making a finding of fact on materiality –

THE COURT: No, I'm trying to recite what is in your own complaint based upon what you quote – when you do quote Price Club, this is what you're quoting. You quote Price Club as saying these things.

MR. STEWART: I disagree.

THE COURT: Well –

[p. 20] MR. STEWART: Respectfully.

THE COURT: You do – the quotations from the releases by the Price Company tell them that there's a modest – they show me what the earnings per share was.

You quote part of the statement by the annual report. Look at paragraph 50. It starts right out by saying,

> "Although an expected weak economy in California during '92 is expected to influence results, the stock price should benefit from the positive earnings contributions of new units that have been opened during '90 and '91."

So right off the bat, they're telling you there's a weak economy out there and it is expected – the weak economy is expected to influence results.

Now, which way would you think that would influence results? Up or down?

MR. STEWART: Number one, your Honor, there's no allegation that the Price Company failed to disclose a weak California economy and there certainly could be no credible –

THE COURT: No, but what about – they're saying that they're expecting that that's going to influence their results? Do you think that they're telling you it's going [p. 21] to influence them up or down?

MR. STEWART: It's simply not relevant to this complaint, your Honor. It's simply not relevant to this complaint.

THE COURT: Then why is it in here?

MR. STEWART: As part of the context of the statement is all.

THE COURT: It seems very relevant to me.

MR. STEWART: Well, again, your Honor, if the Court is prepared to make a finding of fact on materiality without this case ever having been – affidavits being submitted or any discovery, then – you know, one can make that finding, but it should be very clear what is happening.

THE COURT: I don't know that – I – I don't think I'm making findings of fact, Counsel. You keep saying that. All I'm doing is reading the complaint. I mean, you're the one making these factual allegations. I'm simply reading them. I'm not finding them. I mean, maybe they're all – maybe all these statements by Price Club are wrong. Maybe they didn't have any warehouse expansion. You don't allege that they had no plans for a warehouse expansion.

MR. STEWART: That's correct.

THE COURT: What you allege is that, when they got the report on April 2, they changed the corporate

plan. They said, "Oh, my gosh," and they changed the direction of [p. 22] movement, and on April 2 they said, "Hey, we're going to cut back on some of this expansion because we're having some problems," and they let everybody know, and boy, the minute they said that, down went the stock.

MR. STEWART: No, that is not what we're alleging, your Honor. What we're alleging is that there was an announcement and a continued pitch to the public that this accelerated warehouse expansion program was going along. There was no hint of any substantial problems of major risks being presented to the company by the pursuit of this strategy, that there were known risks, there were known major risks, that there were problems and information that should have been disclosed to the public from which they could have looked at –

THE COURT: All I can say is I'm looking at what Price Club – that's really what I'm paying most of my attention to – is to what Price Club said.

What these stockbrokers want to do with what's said – if Price Club wants to say, "Hey, everybody, it's red," and the stockbrokers listen to that and they say, "Did you hear that? It's green. Buy." I mean, that's their business if they want to say that, but if they want to do that and they want to say that, I don't see how Price Club could be liable for that.

MR. STEWART: Price Club could be liable for that [p. 23] because that information is being put into the marketplace by the analysts based on the conversations with management. Price Club –

THE COURT: My hypothetical – my hypothetical was different. I'm saying that Price Club gets up on a podium and they say, "Hey, folks; it's red," and the analysts listen to that and they turn around and say, "Did you hear that? It's green. Buy."

Now, if they want to say it's green when Price Club has said it's red, and then they want to sell a bunch of stock to a bunch of customers, how is Price Club liable for that? I just don't see how you can – how you can sue a company for making factual statements which are interpreted by third persons which drives a market up.

MR. STEWART: Well –

THE COURT: I don't see how you can hold the company, if their statements are factual, if their statements are not misrepresentations, if their statements are not false, if their statements are not material omissions – I agree with your point about material omissions. No question about that.

But if there is an absence of that, then I don't see how in the world Price Club can be liable for a market that goes up. Goodness knows why it goes up. Maybe it goes up because some stockbrokers really push the stock. There [p. 24] are a number of reasons why stocks go up and down. It's a very complicated market.

MR. STEWART: And that's precisely why we can't try this case on the complaint, your Honor. That's precisely why –

THE COURT: Well, I'm not trying to try it on the complaint. I'm just saying that I've looked at this complaint to see whether you state a cause of action

against Price Club. I'm looking at page 36, and it's a quotation from the first quarter fiscal '92 report in which Price Club writes – it says,

> "Although most reports say that warehouse clubs and the discounters did well in the first three months of '91, the Price Company definitely felt the effect of the recession especially in California."

I wouldn't call that a flag-waving report, would you?

MR. STEWART: Standing by itself?

THE COURT: Well, let's read on.

MR. STEWART: I'm sorry, your Honor I've lost your reference.

THE COURT: I'm on page 36, line 10. I'm quoting from your complaint which quotes from the Price Club report to the shareholders. It says,

> [p. 25] "Consumers held back until last week for Christmas, and our business members: restaurants, small stores, small white-collar businesses bought less because of the sluggish economy. Our margins were reduced slightly due to some extra markdowns which were taken to ensure that we sold out of seasonal merchandise. In addition, in five locations, where the company faces strong competition and sales need to increase, overall merchandise margins were reduced."

Man, oh man, does this sound like a company on a skyrocket to the moon? Then it says,

> "Although it is still too early to assess the results of these lower prices, we believe that

> reducing margins and lowering prices is the right policy."

Well, they have a right to believe that, don't they?

> "Lower prices will build volume and keep the company focused on reducing expenses."

So now they're telling you they're in a drive to reduce [p. 26] expenses and lowering their prices. They've had a recession in the market. They didn't have a good Christmas. They had to almost distress-sale seasonal merchandise to get it off the shelves. They had tremendous competition from other warehouse companies, that the California market, especially, was a big problem to them, and Price Club, as I recall from your complaint – you allege that they're biggest in California than they are anywhere else.

MR. STEWART: That's correct.

THE COURT: So here they're telling me that where they're the biggest they're having the most problems.

Then it says,

> "The company plans to open at least eight and perhaps as many as ten additional clubs for the end of this fiscal year, August 31, 1992."

There's nothing unfactual about that.

> "Some of these new locations will be in markets where the club is already well known but one each will open in new markets including Philadelphia, Dallas, Houston and Mexico City. Also, as previously reported, the company plans to open in Chicago in the fall of '92. We are enthusiastic about the [p. 27] opportunities in these

> metropolitan areas, but anticipate that it will take time and expense to achieve profitability because of competitive conditions and the comparatively low awareness of the Price Club."

Well, now, man, oh man, as a result of this, not all of the investment advisers went bananas. You know, some of them went mushrooms. They climbed underneath the ground and covered themselves with you know what and they didn't get all excited about buying stock.

MR. STEWART: Well, I frankly did not see that in the reports. One thing I would note for the –

THE COURT: I didn't see it in your complaint, but I admit that I saw that in some supplemental filings by the Defendant, and I told myself at the time – well, you know, this is a 12(b)(6) motion. I'm not so interested in that. I'm interested in what the complaint says. I'm looking at what Price Club said to the public.

MR. STEWART: Did Price Club say, your Honor –

THE COURT: All I'm just telling you is that some people – you told me that the analysts went bananas with this. You didn't tell me that there were others who didn't. I'm not criticizing you for that, but it was a pretty slanted approach, wasn't it?

[p. 28] MR. STEWART: I don't believe so, your Honor. Not only –

THE COURT: You didn't tell me about any houses that were down on them.

MR. STEWART: I failed to find one.

THE COURT: Well, there were a number of houses that went sideways or said, "Don't buy; hold." None of them said, "Sell." But that doesn't – that isn't exactly –

MR. STEWART: I don't recall a recommendation below outperform, buy, strong buy –

THE COURT: Oh, well –

MR. STEWART: But this is –

THE COURT: Did you read what the Defendants filed?

MR. STEWART: I certainly did.

THE COURT: Well, they filed a couple of houses that said "hold". Didn't you read that?

MR. STEWART: I don't recall.

THE COURT: Well, I recall it.

MR. STEWART: And –

THE COURT: Am I misrecollecting it?

MR. McMAHON: You're not misrecollecting it. In fact, one predicted a decrease in sales – in earnings.

THE COURT: At any rate, that's what – this is the kind of quotation from what the Price Club – then in [p. 29] January of 1992 they held their annual meeting. At the annual meeting they – once again, they gave them a very guarded – very guarded report on what the company's doing. They say, "We're hopeful; we're hopeful;

we're working; we're expanding warehouses, but the earnings are hurting because we've got expense; we've got competition; we're hoping to get something out of Mexico."

On January 16, they said – on January 16, '92, they said,

> "The Price Company will continue to reduce profit margins and lower prices on merchandise to counter a sluggish economy, even as the discount membership warehouse chain seeks new financing to fuel expansion by eight to ten new stores over the next year."

This is what they were quoted saying.

MR. STEWART: Your Honor, that simply is beside the point. The question is whether the information which was alleged to be omitted is found in these statements and whether that was – whether that was a material omission. The Court will not find in these statements –

THE COURT: You haven't alleged – you have not alleged a material omission. I agree with your theory that, if they – if they allege – if you allege that there were [p. 30] material omissions in their financial statement or in their earnings record or something like that, that they are not revealing and that – conceding them – and then they're giving us a rosy picture, all the while experiencing adverse experience, that those admissions are actual – I agreed with you when you said that. The trouble is, I didn't read it in your complaint.

MR. STEWART: Again, I refer the Court to the paragraph that we began to go into and with respect to the –

THE COURT: Well, but can't you give me some facts? All you do is you allege these things, but you have no facts and – so when I look for facts, the only place I find facts are when you quote the Price Club, and when I start looking at the Price Club, they tell me that there's more profit, that there's distress sales of seasonable merchandise, that there's increased expense, that there's low production of new warehousing, that there's a sluggish economy especially in California where we're the biggest, that we're having lower profit margins.

So when I go back to the facts – now, where are the omissions?

MR. STEWART: Because it's all –

THE COURT: Factually, they're painting a very guarded picture of their company.

[p. 31] MR. STEWART: The theory here is that this accelerated warehouse expansion program is going to turn all this around. Of course they've got to –

THE COURT: Well, maybe they were negligent in hoping that; maybe they were negligent in saying that "that's what we anticipate's going to happen in the future." That is not actionable. They can be wrong. They can be wrong and not be suable under Securities Act cases.

MR. STEWART: I agree with the Court 100 percent, but that is not what is alleged in the complaint. What is alleged in the complaint is that they were known facts, should have been disclosed – about whether this program was going to work –

THE COURT: Such as what?

MR. STEWART: Such as whether they were already having problems with new store openings, whether their expenses were already out of line with the forecasts and projections that they had.

THE COURT: You don't allege that they were out of line in their forecast. There's no evidence of that in your complaint at all. There's no factual averment.

MR. STEWART: Well –

THE COURT: And they do say that their profit is down and that their expenses are up and that their startup is producing low profitability.

[p. 32] In fact, they even said in one place that "we're not going to see profitability immediately." That tells me they're not seeing profit.

Well, when they tell me that there's not going to be profitability for awhile, I listen to that and I say, "Well, I infer from what you're saying is that there isn't any profit right now" and that's exactly what's meant. When you tell me, "Hey, we're not going to be profitable for awhile," you're telling me "we're not profitable now and we won't be for awhile." That's what you're telling me, and that's what they told you. And you quote them in the complaint as telling you.

MR. STEWART: I agree with the Court. But the question is not whether they turned the profits or not. The issue is whether they were meeting their forecasts and projections with respect to where this warehouse expansion program was supposed to be taking them. That is the point at which we take issue.

It's not just a question of culling these statements and seeing if we can find some adverse information so I can make an argument to the jury that all this is not particular. We're at the outset of the case, and –

THE COURT: You're at the outset of the case where what you've got is a downturn in the market by $13 and [p. 33] within 24 hours of that downturn a complaint is filed for a class action securities fraud case based upon the downturn in the market, the complaint – to the extent it's based on the facts is based on truthful statements by the Defendant, and then factual averments of what analysts did with those factual statements, and you hinge your wagon to that star and run into court and file it and you have no evidence of any falsification at all by the Defendants.

So here's the dilemma. You don't have enough facts in this complaint to require the Defendants to answer it, but the problem is how are you going to get any facts? Maybe there are facts in it maybe there is some falsity going on, but how are you going to find out about it if you're not allowed to sue them and then get into their skivvies with discovery?

MR. STEWART: Well, that's –

THE COURT: So which comes first: some basis to file the suit or do we just let people – when the market goes down, we let them immediately file suit against mega corporations and run up their legal expense by millions of dollars while you play around and see if there's anything in there and, if there is, great; here we go, and we're going to get attorney's fees and everything else.

But if there isn't, well, then we fold up our tent and we whimper away. In the meantime, the Defendant is [p. 34] standing there with a million dollars or so of attorney's fees, and who do they collect that from? They're going to collect it from your clients? In a pig's eye.

So what is this: a one-way ballgame here? Are you willing to put up a bond for attorney's fees in case you don't have anything in this thing – for the privilege of going into their files? The law doesn't require it.

The 34 Act under which you sue doesn't require a bond for attorney's fees. It doesn't even require a bond for – well, I think it requires a bond for costs, but it doesn't require a bond for attorney's fees. Court costs are a small pimple on the great behind of these kinds of cases so far as the Defendant's concerned. They could pay those court costs out of petty cash. Attorney's fees are something else.

So, you know, what kind of a ballgame is this? It's heads, I win; tails, you lose? Is that what we're doing here?

MR. STEWART: It's no kind of a ballgame, your Honor. When people buy stock based on a business plan and feel that information that they should have been given about that business plan was withheld –

THE COURT: Well, the business plan was – the business plan was stated to them, but it was – you haven't alleged that they didn't have that business plan. You [p. 35] haven't alleged that they didn't intend to do what they said they intended to do.

MR. STEWART: That is not the case. What we have alleged – is that they have omitted information about how they were making out with that business plan that should have been disclosed and that – when the –

THE COURT: I don't think so. I don't read that. They told you they were having all kinds of problems with their – with everything they were doing – was giving a problem. Warehouse expansion was giving them problems. Sluggish economy was giving them problems. Profitability was giving them problems. Profit margins were giving them problems. Expenses were giving them problems. They told you – problems, problems, problems, every time they opened their mouth.

But they kept saying, "But we're fighting and we still think we can win this problem; we can win this battle, and we think the way to win it is by expanding our warehouses and cutting our expenses and getting those warehouses on the ground – getting our recognition in some of these areas, and we're going to – we hope we're going to be back into the profitability which we admit we don't have right now."

Now, what's wrong with that?

MR. STEWART: What's wrong –

[p. 36] THE COURT: What's actionable about that?

MR. STEWART: What's wrong with that is, if there is material information that that company has –

THE COURT: Such as what?

MR. STEWART: Such as that they are already having unprofitable results in stores such as Denver and Vancouver –

THE COURT: They told you that. They told you that. They told you – they may not have identified Denver and Vancouver, but they did say that some of the new warehouses weren't yet profitable.

MR. STEWART: Well, I respectfully disagree.

THE COURT: Well, it's not a fair fight. You know, I understand that. I appreciate your position, but I have to do what I have to do. I just look at this and I say to myself, "This is nothing but a negligence and a strict liability complaint," and I don't think the Defendants are strictly liable for results in a securities fraud case.

There has to be allegations of fraud, misrepresentations of material facts upon which people reasonably relied and are damaged.

Material omissions certainly can be alleged and, if there's facts there, fine. I'll tell you what I'm going to do. I'm going to grant the 12(b)(6) and I'm going to grant the 9(b) 'cause there's no – there's not even a [p. 37] scintilla of allegations of fraud with the particularity that you have to allege on fraud.

Let me address one other thing before we break up. Three people apparently sold stock. In a vacuum, that couldn't mean less to me. I mean I suppose they get stock options and they're given stock – try to buy it at a bargain basement price and then they go out in the market and sell it. I don't know – you didn't cite me any law that says

that it's illegal for a corporate officer or an employee to sell company stock. I mean, I wasn't aware that it was illegal. Is it illegal to do that?

MR. STEWART: If the company officer has knowledge of nonpublic, inside information, it certainly is.

THE COURT: Such as what? A false – you mean information that's being falsely transmitted.

MR. STEWART: Information that the public statements of the company –

THE COURT: Are false.

MR. STEWART: Or are omitting to state information that should be disclosed – material information.

THE COURT: Okay. So – all you've given me is you've told me what they've said which I don't find to be untruthful or unfactual, and then you told me that three of their people sold some stock. I put those together and I look at it and I say, "So what?"

[p. 38] MR. STEWART: Well, I agree with the Court. If the Court feels that it can make a finding on this complaint, that there are no statements that are untruthful or misleading, then certainly there's nothing illegal about selling stock.

THE COURT: I don't make any such finding, Counsel. Once again, don't put any findings in my mouth and then knock them down because I'm not making any findings. All I'm telling you is you allege that they said these things, and you don't allege that they're false.

MR. STEWART: Well –

THE COURT: You don't allege that they are false. For example, when they say, "We're having profitability problems, and our new warehouses aren't going to be profitable for awhile," you don't allege that that's false.

When they tell you that the market, especially in California, is very sluggish, and we're hurting, you don't tell me that that's false.

When they tell you that their expenses are high and that the competition is keen with these warehouse businesses, you don't tell me that that's false.

So where am I supposed to make a finding that these statements that they're making are false?

MR. STEWART: Well, I guess we've gone over all the ground. I disagree with the Court on the [p. 39] characterization of the complaint. I think we have fairly characterized in the complaint that there was material information that was omitted from the statements that had to be disclosed in order to render them not misleading.

THE COURT: Well –

MR. STEWART: If the Court doesn't feel we've done that, I'd ask –

THE COURT: I don't think you've done that, but I'm certainly willing to give you leave to amend. You're entitled to try at least – the first time you amended was on your own. I'm not sure – I'm not going to charge

you for that. I'll certainly gave you a chance to amend again. How many days do you want?

MR. STEWART: Thirty days, your Honor.

THE COURT: Is that enough?

MR. STEWART: Yes.

THE COURT: Okay. You got it.

MR. McMAHON: Your Honor, may the discovery stay remain in effect during that period of time –

THE COURT: Yes, except for the discovery of the third parties' files.

MR. McMAHON: Well, we already –

THE COURT: Put them on notice that they're going to come after them eventually.

MR. McMAHON: The Court has already granted a [p. 40] ruling in that respect, and I take it all the Court is saying the Court's not changing that ruling.

THE COURT: I'm not changing that ruling.

MR. McMAHON: But the discovery stay will remain in effect.

THE COURT: I think so because I think in fairness – I think in fairness – unless there's some protection that runs both ways, then it seems to me that the order should remain just the way it is.

MR. STEWART: Your Honor, I'm advised that I should ask for a little more time. Could I have 45 days to amend?

THE COURT: Any objection?

MR. McMAHON: No.

THE COURT: Very well, 45 days from today.

MR. STEWART: Thank you, your Honor.

MR. McMAHON: Thank you, your Honor.

THE COURT: We,ll prepare the order.

(Proceedings concluded.)

I certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter.

/s/ Mary Lou Lohr — Transcriber

9-29-92 — Date

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO and JOSEPH LASENSKY, on Behalf of Themselves and All Others Similarly Situated, Plaintiffs, vs. THE PRICE COMPANY, ROBERT PRICE, DENNIS ZOOK and TED WALLACE Defendants.	Civ. No. 92-0497 B (P) ORDER GRANTING MOTION TO DISMISS WITH LEAVE TO AMEND (Filed Oct. 1, 1992)

On September 21, 1992, the above captioned matter came on regularly for a hearing before the Honorable Rudi M. Brewster. Gerald McMahon, Esq., and James Delphey, Esq., appeared for defendants; Dennis Stewart, Esq., appeared for plaintiffs; Howard Finkelstein, Esq., appeared for plaintiff Joseph Lasensky. Upon consideration of the motion briefs and oral argument, the defendant's motion to dismiss under Fed. R. Civ. Pro. 12(b)6 and Fed. R. Civ. Pro. 9(b) is granted. Plaintiffs have failed to plead fraudulent conduct by the defendants with sufficient particularity, and have failed to state facts sufficient to constitute a cause of action against defendants. Plaintiffs are granted leave to amend up to and including November 5, 1992.

IT IS SO ORDERED.

DATED: SEP 30 1992

/s/ Rudi M. Brewster
UNITED STATES
DISTRICT JUDGE

cc: all counsel

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, Plaintiff, vs. PRICE COMPANY, Defendant.	)	Case No. 92-0497-B Civil

TRANSCRIPT OF MOTION HEARING
Taken in San Diego, California
March 9, 1993

BEFORE THE HONORABLE RUDI M. BREWSTER

Echo Reporting
7046 Enders Avenue
San Diego, California 92122
(619) 453-3325

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, Plaintiff, vs. PRICE COMPANY, Defendant.	)	Case No. 92-0497-B(BTM) San Diego, California Tuesday, March 9, 1993 10:00 a.m.

TRANSCRIPT OF MOTION HEARING
BEFORE THE HONORABLE RUDI M. BREWSTER
UNITED STATES DISTRICT JUDGE

APPEARANCES:

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[p. 1] SAN DIEGO, CALIFORNIA
TUESDAY, MARCH 9, 1993 10:00 A.M.

(Call to order of the Court.)

MR. LERACH: May it please the Court, Bill Lerach, my partner Dennis Stewart and Robin Williams of Milberg Weiss for the Plaintiffs.

MR. FINKELSTEIN: Howard Finkelstein, your Honor, on behalf of one of the named Plaintiffs, Joseph –

THE COURT: Good morning. The second name was Stewart –

MR. LERACH: Dennis Stewart and Robin Williams.

THE COURT: Robin Williams. Okay. Good morning, Counsel.

COUNSEL: Good morning, your Honor.

MR. McMAHON: Your Honor, Gerald McMahon and James Delphey of Seltzer Caplan Wilkins & McMahon for the Defendants and moving parties.

THE COURT: And the second name was –

MR. DELPHEY: Delphey, D-E-L-P-H-E-Y.

THE COURT: D-E-L –

MR. DELPHEY: P-H-E-Y. James.

THE COURT: Good morning, Counsel. I appreciate your coming in this morning at 10:00. The motion requires more work than would be available to the Court

on law and motion on Monday morning, and that's why we moved it over to [p. 2] today.

The Court has reviewed at great length the moving and responding papers on this second series of motions to dismiss the second amended complaint.

The Court has compared the second amended complaint carefully with the first amended complaint. The Court has accepted as correct the assertion which wasn't – actually which wasn't refuted by the Plaintiffs – assertion made by Defendants that, where the Plaintiff quotes material – quotes from material in the complaint, that the Defendant can refer the Court to the report itself within the confines of the 12(b)(6) motion. I perceive that that's correct, and there wasn't any dispute about that made by the Plaintiffs, and I hear none now.

If you quote paragraph 1, the two-paragraph report and incorporate it into your complaint, the Defense in bringing the motion to dismiss can cite the Court to the other paragraph of that report in the declaration which normally are not received in 12(b)(6) motions.

MR. LERACH: Well, as a matter of strict pleading rules and 12(b)(6) jurisprudence, I do not believe that is correct. I believe the Plaintiff attaches it to his complaint. The Court can – and then excerpts it. The Court can refer to the whole document, but I don't think that's settled law, necessarily, at all.

[p. 3] Now, I realize they did it here, and the issue then becomes whether it's turned into a Rule 56 motion, but as a matter of formalistic liberal argument, I do not

want to waive that point because I don't think it's right under 12(b)(6) jurisprudence.

There are other remedies available to them.

THE COURT: You didn't object to it in your reply papers.

MR. STEWART: If I may, your Honor, in the original go-round, we had quite a lengthy, I believe, footnote that objected to that in the first opposition brief.

I don't – I'm not sure if it was raised again in the opposition papers –

THE COURT: I didn't see it this time around and, to be honest with you, I didn't reread your briefs from the first go-round. I did read your briefs from the second go-round, and I didn't see it in your reply to the Defense – 'cause they of course make a big point of it.

MR. LERACH: I know they do and –

THE COURT: And there was no response.

MR. LERACH: Well, I think, as I said in the first – as Mr. Stewart has said, in the first round of briefing, we did brief the point.

As a matter of 12(b)(6) jurisprudence, I really [p. 4] believe, with very limited exceptions, the Court is limited to the four corners of the complaint, and it's our view here we have not unfairly excerpted from materials.

We haven't ripped things out of context, and it really creates a serious problem when Defendants then begin to pick pieces out and make their arguments.

But I hear the Court. I know they filed the declaration, but I don't want to waive that point as a matter of law because I think that the law would support us on the point.

THE COURT: Do you have any Ninth Circuit authority on the issue?

(Pause.)

MR. LERACH: I don't have it at hand, but I'll be glad to give it to you by way of –

THE COURT: Well, I'm surprised it wasn't put in a reply because the whole Defense in this motion is money – essentially is based upon this proposition.

I mean, that's kind of a key log in the stream of our discussion.

MR. LERACH: As Mr. Stewart said, we did brief it extensively first time around, and footnote 1 in the brief on the second amended complaint asks the Court to respectfully refer to our first memorandum.

I don't want to be unduly technical about it with [p. 5] your Honor –

THE COURT: Where is it – let's – have we got your memorandum from the first go-around where this was addressed? See if you can find it – help me be able to find it.

Let me inquire of the Defense counsel. Do you have a case that supports –

MR. McMAHON: Yes, your Honor. First of all, the Defense cited the first go-around, and again, this time

Robboney vs. Shearson, Lehman, Hutton (phonetic), First Circuit, 1991 decision, 929 F.2d 875 at page 879 note 3, it cites a number of other authorities for the proposition, but where the Plaintiff refers to a document, it is proper 12(b)(6) motion practice for the Defendant to put in the entire document.

In addition, in the Ninth Circuit, we have the *Verifone* (phonetic) case – the *Verifone* case, Northern District of California, 784 F.Supp. 1471.

In addition, I believe the *Rentelle* (phonetic) case, recently decided in the Central District, on a motion to dismiss, permitted the defendants to put in the entire document that the plaintiff was referring to.

THE COURT: Was that – were either of those cases reviewed?

MR. McMAHON: Not yet, your Honor.

[p. 6] THE COURT: Are they in the Ninth Circuit now?

MR. LERACH: Yes, they are.

THE COURT: On that issue?

MR. LERACH: That is one of the issues.

MR. McMAHON: With regard to the Plaintiff's footnote the first time around, I want to check the papers, but I believe what the Plaintiff was concerned about the first time around on the motion to dismiss was – we have it here.

THE COURT: Plaintiff's reply –

MR. McMAHON: Plaintiff's response to our motion to dismiss the first time around.

THE COURT: Plaintiff's response to the Defendant's –

MR. LERACH: Now, footnote one is in the second brief. We've now – referring back to the first memorandum.

THE COURT: Where would I find this point raised in Plaintiff's memorandum? I haven't – Plaintiff's response to the first round of motions.

MR. STEWART: It's in a footnote. If I could take a minute to look at that. I'm sorry, I don't have a copy. May I, your Honor?

THE COURT: Would you like to borrow mine –

MR. LERACH: McMahon – Gerry has one. He'll let us look at his.

[p. 7] MR. STEWART: Yeah, if you can locate it then –

THE COURT: I have one if you want to borrow mine.

(Pause.)

MR. LERACH: It's footnote 11, page 12.

THE COURT: Footnote 11, page 12.

MR. LERACH: The Ninth Circuit case – we cite two of them there. *Hal Roach Studios* (phonetic) and

Amfact Mortgage (phonetic). I won't read the cites because you have them.

THE COURT: Footnote – you said footnote 11?

MR. LERACH: Page 12.

(Pause.)

MR. McMAHON: You see, the point is they incorporate by reference these documents in the complaint so that what is going on here complies with the law as cited in Plaintiff's footnote.

THE COURT: Well, you know, there is a gentleman who has spent a lifetime – a couple of gentlemen who have spent a lifetime telling Federal judges how to conduct their business, and they've written a series of books and they're called Wright & Miller, *Federal Practice and Procedure*. I suppose you gentlemen have heard of that, just in passing.

MR. McMAHON: We subscribe.

THE COURT: Well, so do we, and at page 763-64, section 1327, the book says that when Plaintiff fails to [p. 8] introduce a pertinent document as part of his pleading, Defendant may introduce the exhibit as part of his motion, attacking the pleading.

Accordingly, the Defendant may introduce, and the Court may consider, prospectuses and other documents from which Plaintiff has taken excerpts and consider it in a motion attacking the pleadings without converting it into a summary judgment motion.

See – and then he starts citing some cases, and he cites us to *Pekas and Associates vs. Oppenheimer* (phonetic),

Second Circuit, 1991, 936 F.2d 759 at 762. Also cites *Robbony vs. Shearson, Lehman, Hutton* 929 F.2d at page 879 note 3, which cites in turn *Fudge vs. Penthouse International, Ltd.* (phonetic) 840 F.2d, First Circuit, 1988, and it cites back to Wright & Miller.

Then it also says see also *In Re: Verifone Securities,* which is the Northern District of California, District Court case.

I think that – I think it's probably not inappropriate to review the other – as Paul Harvey would say, "the rest of the story."

If I – I think that the Plaintiff is going to give me the front page of a document and urge me to go along with the Plaintiff – the case based on the front side.

I think if there is anything material in the back [p. 9] side, I think that the Defendant should be allowed to present that to the Court without taking on the additional burdens of summary judgment which contain more finality, more of an impact on the parties.

MR. LERACH: We respect your Honor's view, I just did not want it to be waived on us – our argument on the other side.

THE COURT: Okay, well, then let's leave it at that. I won't attribute any waiver to the Plaintiffs, but I think it is an appropriate approach to take, and I took that approach in analyzing these pleadings.

Let me say at the outset what my tentative conclusion is because then I want to hear from Counsel, as appropriate, to show me where I may have gone off the track.

It appears to me from a review of the second amended complaint – and that review meaning analyze the complaint and its citations in the context of the broad documents themselves which were furnished by Defense Counsel in two declarations, the declaration of Jacqueline Horton (phonetic) and a supplemental declaration of Jacqueline Horton.

One was filed on May 12, 1992 and the other one was filed on August 14, 1992.

Can the Court analyze the second amended complaint in that manner?

[p. 10] From the analysis, the Court makes these candid conclusions: the second amended complaint adds nothing. In fact, I think detracts somewhat from the first complaint – first amended complaint, and doesn't strengthen the Plaintiff's cause of action against the Defendant.

In taking the complaint and reading the complaint, in the light of all of the excerpted material, the Court concludes that there isn't any cause of action stated for any of the four alleged causes of action.

There is no – there is no cause of action stated for a 10(b)(5) violation.

There is no cause of action for any supplemental jurisdiction claims of fraud and – third and fourth kind of parasitic to the first and second.

But the Court concludes tentatively that it looks to me like the complaint – when you do this and review it in that way, you look up after you've read all of that and

you say, basically, "So what? So, what are you telling me?"

I don't see any – I don't see any misrepresentations. I don't see any deception.

There is no allegation of fraudulent intent. There is no allegation of deliberate conduct – for example – let me give you an example.

It is alleged in the complaint in paragraph 57 – it is alleged that suddenly on April 2, 1991 – I [p. 11] think you meant 1992.

MR. LERACH: That's right.

THE COURT: Okay. Suddenly on April 2, 1992 – I'm going to refer to it as 1992 – Price Company shocked the investment community when it revealed that its net income for the second quarter – it would drop to 14 cents a share and revealed that its [sic] losing – that it was losing money on its newly opened stores due to the expansion program and it was sharply curtailing its plans after the 1992-93 year.

Now, there's no allegation here that the Price Club directors and officers had made this decision to sharply curtail its plans months earlier and were holding out a false picture of a policy of expansion.

There is no allegation of that. It just alleges that they changed their policy and they announced it, and the result of that announcement caused a plummet in the Price Club stock.

So, I'm asking myself, well, assuming, that they honestly believe throughout this prior period of the class

period – assuming that the Price Company management was not lying to its public when it was telling them through all these months about its expansion plans and, indeed, its purchases and its consolidations and its refinancing of all their stores, its creation of the real estate investment [p. 12] trust.

I mean, the whole picture that's painted is a picture that Price Club was set on a policy of expansion, and that in April of 1992 all of a sudden they changed their mind and they now adopted a policy of curtailment after the 1992-93 year.

If it's true that Price Club did indeed have that genuine policy of expansion until the actual point where they realized that this is not a good policy and it's not going to be profitable in the future, and so they changed the direction – excuse me, changed the direction of policy from expansion to curtailment.

Doing that doesn't cause a liability under the Securities Act.

I mean, companies have the right to adopt policies through management of the company.

What they don't have a right to do is to adopt policy A and then tell the public that their policy indeed is policy B, and then while they're secretly following policy A, they're telling the public that they're following policy B.

That is actionable, but the Plaintiff doesn't allege that they did that.

So, let's go – what I get – and I don't know how much time we ought to take of this.

[p. 13] Let me suggest this to you. I went through each of the paragraphs starting with paragraph 27, and I went from 27 through 57 and I looked at the allegation of the complaint and then I reviewed the source material to see whether there was anything that was balancing or that was guarded in the source material which was not set forth by the Plaintiff.

For example, in paragraph 27, this is a Price Club report, it's – I think it's quite optimistic.

It's dated April 3, 1991 and it announced a policy of accelerated expansion.

They announced that they're dedicated to following this policy and that they're going forward with it and they have great hopes that they're going to have success.

They say at the very end of it – even the Plaintiff alleges – the allegation by the Plaintiff contains – 21 – the quotation by the Defendant, "We feel a little more optimistic about our near term future than we did at the end of the last quarter. Sales seem to be more solid now than they did."

Now, this itself is an admission that they were not too happy with the sales immediately behind them.

So, that's a statement of policy and it's a statement of intent and it's a statement of expectation.

There is no allegation that none of those [p. 14] expectations were not believed by management.

Now, starting with paragraph 28, then we have a third party report. This is not a Price Club report.

It's guarded. Even it is guarded because it says they recognize that there are some earnings problems and they believe – this third party believes that there will be an earnings turn around – at seven and a half.

They say it has gradually unfolded. They believe it's based upon modest improvement in warehouse sales and an accelerated pace of opening new units.

So, I looked at the Defendant's submission on that – paragraph 28, which is in the supplemental declaration. It's identified by the Defendant as Tab 1.

In this, you find – you find a great deal more guarded comments in that quotation than the Plaintiff quoted.

For example, just – maybe you have it in front of you. It might be helpful – do you happen to have the declaration – the supplemental declaration?

MR. LERACH: I don't have it right here. I think we have it – but go ahead. I can –

THE COURT: Have you got it here in court?

MR. LERACH: Yeah.

(Pause.)

THE COURT: If you take a look at Tab 1 of the [p. 15] supplemental declaration of Jacqueline Horton.

MR. LERACH: Okay, your Honor, go ahead.

THE COURT: Okay. In paragraph – which is – about the sixth line down, it says comparable warehouse sales on the West Coast improved to flat from negative by

the end of the quarter – warehouse sales of the East Coast are increasing at a slow, single digit pace.

Currently, the cannibalization on the East Coast is the number one factor dampening warehouse sales increases.

Then paragraph – 82, it says average volume for a warehouse continues to decline.

In the second fiscal quarter the average volume per warehouse was $104, down 10.4 percent from $116 in the year earlier quarter.

The decline in average volume reflects increased cannibalization and more units in new markets which have lower initial volumes.

Then, jumping to the second page of this report, there is – the report says outlook – paragraph 3 it says, "Warehouse sales should gradually improve over the next few quarters and by the second quarter of fiscal '92 the improvement could be quite dramatic".

"At that time, the nine units price opened in the first quarter of the current fiscal year will all be [p. 16] comparable and significant cannibalization will also be anniversary".

I'm not sure I know what anniversary means. That's probably a word of argument. Marketing history, I'm not sure I know what that means. I know what an anniversary is, but I don't know how that's used. I just don't know. Maybe Counsel will.

But looking down here, investment conclusion. This third party continues in the fourth line, it says, "The essentially flat earnings performance in the second fiscal

quarter reflected many of the negatives from stepping up expansion, but none of the positives. Comparable warehouse sales, for example, are being penalized by cannibalization from new openings while the offset – the number of new units going into the comparable warehouse pace remains relatively small".

There's a lot of very guarded language in this quotation from the Wertheim, Schroeder & Company's report, which is not authored by Price Company, and which is cited in part by Plaintiff in paragraph 28, and when you take a look at the whole report of Wertheim & Company, you get a very balanced picture which tells the story that they are having a lot of problems with their new warehouses, they're having flat earnings performance, they're having increased expenses and poor performance, and they hope that in the [p. 17] future when they get the wrinkles out of them that they're going to pick up.

Looking at paragraph 29, this – and if you will look at Tab 2 in your Supplemental Declaration, you'll see – because paragraph 29 is another third party quotation that the Plaintiff has incorporated. That's the First Boston Corporation, and when you look at the First Boston total report, which is in Tab 2 of the Supplemental Declaration, you will see on page 2, among other places, it says in the first column, the second paragraph, it says, "Selling, general and administrative expenses are going to continue to run higher as the percentage of sales, as Price Company's average warehouse volume is down 10 percent this last quarter, from 1.9 mil to 1.7 mil per week because of its heavy, more younger warehouses. Also, of course, the company has been impacted by cannibalization and new warehouse competition".

These remarks are very guarded and they are very balanced. The Plaintiff alleges that these third parties get their material for these investment advice things which they have published. The Plaintiff alleges that they get them from the Price Club, and if they do they're getting the bitter with the sweet but the Plaintiff doesn't allege in the complaint – they don't allege what I refer to as the rest of the story. They take portions of these pieces and [p. 18] then incorporate them into the complaint and ignore the other parts which clearly are guarded remarks about the performance of the new warehouses and guarded remarks about the difficulties that Price Club is having with their expansion program.

And the Plaintiff seems to regard that the expansion program is very germane to their lawsuit here, and I suppose it is, because I think – it seems to me that it is pretty obvious, because when the warehouse – when the Price Club announced in April of 1992 that they were curtailing their warehouse expansion program, their stock dropped about in half, almost within days.

So clearly, the expansion program – and the Plaintiff alleges that no disclosures – look at paragraph 30 – this is the Plaintiff alleging now, they are not quoting from any material.

The Plaintiff alleges on paragraph 30, on line 11, that the Price Company made no disclosure of any risks, uncertainties, or problems concerning Price Company's business, which make it reasonably likely the Price Company's history of earnings increases could not be continued.

Now, that allegation is simply not supported by the source materials which the Plaintiff cites. You just can't – you just can't make a statement like that, and then [p. 19] at the same time refer the Court to these documents the Price Club has published, because it's not true – it's not a correct allegation.

Take a look at the Declaration – take a look at the declaration of Horton, and it's on Tab 2 of the Horton declaration, and this is the Price Company – a report of April 29, 1991.

It's the 10-Q reporting on the first – for the second quarter of – ending March 17, 1991. And if you look at that 10-Q, the Plaintiff says that they made no disclosure of any risk or uncertainties or so forth, if you take a look at that 10-Q, starting on page 7 of it, the first – the second paragraph, it says, "For the first two quarters, the fiscal year 1991, cost of goods sold as a percentage of sales was essentially flat compared to the prior year with a decrease of 200-hundredths of a percent to 91.33 percent from 91.35 percent. Cost of goods sold as a percentage of sales increased .23 percent to 91.19 from 90.96 in the second quarter of fiscal year 1991 compared to the same period the prior vear. This increase is due to the slightly lower margins at the Canadian warehouses, and at those new U.S. warehouses operating in competitive markets. Selling, general and administrative expenses as a percentage of sales increased .59 percent to 8.36 percent in the second quarter of fiscal 1991 compared to 7.77 percent in the same [p. 20] quarter of the prior year, and .3 percent to 7.78 percent year-to-date primarily due to higher operating costs of the consolidated Canadian operations, increases in operating expenses at the warehouses,

increases in expenses in the operation and development of other business activities e.g., optical dispensing, one-hour photo and pharmacy, and increased pre-opening expenses related to new warehouses".

And jumping down another paragraph – two down. It says, "Interest expense increased 36.4 percent". It says, "This increase is primarily due to increased short-term borrowings and interest on the 6-3/4 percent debentures that were issued during the second quarter of fiscal 1991". This – and then the next page 8, it says, "Reviewed by independent auditors". It says, "The consolidated condensed financial statements as of March 17, 1991 and for the 12-week period then ended have been reviewed prior to filing by independent auditors, Ernst & Young, and their report is included herein." And so the auditor's report was included.

But for the Plaintiff just to allege in paragraph 30 that this report makes no disclosure of any risks, uncertainties or problems concerning Price Company's business, which made it reasonably likely that Price Company's history of earnings increases could not be continued, is simply, I think, not being faithful to the source documents that are being alleged upon.

[p. 21] Now, look at paragraph 31. Paragraph 31 is another third party quotation that the Plaintiff relies upon because their problem with the market theory is the law for the first cause of action, at least, maybe it will be for all of them when the Supreme Court comes down with – but at least it's from the Federal case now, and even the portions alleged in paragraph 31 of the Plaintiff's complaint, look at page 27, lines 6 through 14, it

says, "The Price Company has recently reaccelerated its warehouse expansion plan after a period of slower growth. While the addition of these newer less mature units will initially depress average unit sales volumes, and operating profitability, the longer term implications of this shift in strategy are significant". Then they go on to say, "In the long haul we foresee improvement in the sales comparisons that have recently been flat to down modestly".

So to say that this information – of course it's alleged that this information by the third party – in this case it is Alex Brown & Sons – is based upon Price Company's contents – I assume that it is, and if you look at the total document which you are quoting from you will find it in the Declaration in Tab – here it is – you will find it in Tab 1 – no, that's not going to help you, because these tabs – these tabs are not numbered sequentially.

[p. 22] This is an index to Exhibit – oh, I beg your pardon. Look at Exhibit B – okay – look at Exhibit B, Tab 1, and that's the report they are referring to. And if you look at that, there are additional remarks made by Alex Brown & Sons which is partly quoted in paragraph 31, and if you will look at the first page of that exhibit, it says on the second dotted paragraph, which starts "Accelerated store openings to enhance earnings growth" – it says, "The company recently accelerated its unit expansion plan and although the stepped up rate of warehouse openings is likely to initially depress average unit sales volumes and operating profitability, the longer term positive impact of sales and earnings growth appears significant, and we", meaning Alex Brown & Company, "we project five-year growth and earnings", blah, blah, blah.

Well, they are entitled to project whatever they want to project, you know, but they are not the Defendants here – the Price Club is the Defendant here – and that's a projection of Alex Brown, not a projection of Price Club.

Looking at page 3, of that same enclosure – another dotted paragraph – it starts, "Rapid warehouse expansion resumes with positive implications for earnings growth".

It says – it says, "While the addition of these newer less mature units will initially depress average unit [p. 23] sales volumes and operating profitability, the longer term implications of this shift in strategy are significant".

Then it says, "As these warehouses enter the comparable warehouse base we foresee improvement in comp unit sales comparisons that have recently been flat to down modestly".

And then in the next page of that report, page 4, it says "risk factors", and it says, "Contribution of new warehouse additions. The greatest risk factor to our earnings expectations and to observers' perception of the Price Company as a growth vehicle, lies in the timing of profit contributions from the company's recently reaccelerated expansion program. The company has done a superb job in maintaining high unit sales volumes in the face of a significant competitive onslaught in California, however, many new units will be located on the East Coast far from the company's headquarters in San Diego. We believe that some uncertainty surrounds the earnings impact of the added units, however, the shares modest valuation relative to the market appears to adequately discount this concern".

So there is a great deal of concern in these documents – a great deal of caution is to be spoken.

Take a look at page 9 of this same report, and a dotted paragraph says, "Earnings, growth, accelerating" the [p. 24] dotted paragraph, I'm reading about three sentences down, it says, "The addition of these newer less mature units will initially reduce average warehouse sales and company-wide operating profitability, but the longer term positive impact on both sales and earnings is significant as these units begin to contribute to overall results".

So there are all kinds of warnings being given about don't look for short term rainbows – if you want to hang on for the long pull, we are optimistic that eventually we are going to have a very profitable program.

Take a look at page 11, "Comparable warehouse sales growth due to increased penetration in existing markets and inclusion of immature units into the comp base". Then it says, "The inclusion of these newer units into the comparable unit sales base should enable the company to generate stronger comparable warehouse sales growth which has been flat to declining as a result of cannibalization and competition"

At the bottom of that same page it says, "Recent operating results and projections", it says, "Fiscal year 1990, the Price Company turned in sluggish growth during fiscal year 1990 as new units cannibalized existing locations. Total revenues rose eight percent, while comparable warehouse sales increased two percent. The inclusion of seven immature units into the warehouse base [p. 25] impacted margins only slightly".

So this report is lengthy – it's about – I've already gone through 14 pages of this Alex Brown report, but the Plaintiff only quotes from two small paragraphs of the whole report and these portions that I have read from are mentioned on lines 11 through 13 on the Plaintiff's complaint, and on lines 7 through 10, and even the Plaintiff's allegation is a cautionary statement by this third party, plus finding, once again, it isn't Price Club's conduct – the Plaintiff is simply quoting a third party who is accurately quoting correct information given by Price Club, but then based upon that information, some of which is pessimistic, they turn around and strongly recommend you buy the stock, so – I mean – I don't know how Price Club can be responsible for somebody looking at dirt and think they're looking at manure – something more productive than they're looking at – I don't know.

Then paragraph 32, this is a Price Club quote, and if you look at the declaration of Horton, and it would be Tab 3 of Exhibit A. This is the Price Company's consolidated income statement, which is quoted by the Plaintiff in paragraph 32. The Plaintiff quotes from that, and even the portion of that report has cautionary language in it.

You will note on page 28 of the Complaint, it [p. 26] quotes from lines 4 through 10 on that page and it says, quoting – I think they're quoting Mr. Price here, it says, "I see an overall improvement – looking ahead to fiscal 1992 I see an overall improvement in the sales trend due to the introduction of meat and bakeries in many existing locations, as well as a large number, 24 new Price Clubs opened in 1990 and '91 and a general improvement in the economy".

And then he says, "Earnings may not increase at as high a rate as sales because of the substantial real estate investments plan for new locations and operating costs associated with opening new Price Clubs, particularly those units in Texas and Mexico. I strongly believe that shareholder interest will be best served by taking a long-term perspective in planning the growth of the Price Club".

And then looking at the full document that I just quoted from, a portion of paragraph 32, you find the letter to the shareholder dated June 26, 1991 and that's what the Plaintiff is quoting from in paragraph 32. And not only does the cautionary language which the Plaintiff quotes appear, but in addition to that, if you look down on the fourth paragraph of the shareholder's letter, it says – he says, "The Chic Talwaga (phonetic) Buffalo Price Club will be closed as of Saturday, June 29. Although the Chic Talwaga Price Club employees of the East Coast management [p. 27] team made a maximum effort to increase sales, the progress we hoped for did not materialize. Fortunately, because the property is owned and controlled by our company, we were able to quickly lease the building to a high quality national retail tenant. The net result for the company will be to convert a current loss at the Chic Talwaga Price Club into an income producing property".

So there is a very, very definite disclosure of some difficulties with some of these new plans, and the expansion, not all of them – if you drill a hole, you don't always strike oil. That's apparently a dry hole.

And then – then the Plaintiff quoted the next to the last paragraph in that exhibit, which is contained in the quote on page 28 of the second amended complaint, but the bottom line of all of this that I have gone through so far – every one of these paragraphs – and what I did – it took a lot of hours. In fact, it took days.

I went through each one of these paragraphs of this complaint, and I got out the source material which was furnished by the declaration and that supplemental declaration furnished by the Defendants. And I read them juxtaposition with the Plaintiff's allegations and in each single – every single case, the material brought in additional risk identifying factors – additional problems – additional expense warnings and guardings about what's [p. 28] going on. And if you do that, you will find that there isn't a scintilla, as far as I can see, there is not a scintilla of misrepresentation on anything by the Defendant. I can't find a scintilla of any misrepresentation.

Unless you can tell me, Mr. Lerach, that the management knew long before April '92 that they were going to curtail expansion, all the way telling consultants and the public that they were expanding. If you can allege – which you haven't – but if you could allege that while they were telling the public and their shareholders that they were following a policy of expansion, when, in fact, they had made a corporate decision to do the opposite, I would certainly be happy to read that in an amended complaint. Short of that, I think you better – I think you better go find another corporation to attack.

Now, I think you probably want to speak, rather than Mr McMahon.

MR. LERACH: It doesn't sound to me like he has too much to say, so I'll go first, and I won't take a lot of your time.

THE COURT: I didn't go through the rest of this – I mean, I got the notes – I've got each one of these tabs marked, and I went through every one of these paragraphs – I've got three pages of reference to go through and rather than take you agonizingly up through page [p. 29] – paragraph 57, I stopped at 33, because I'm making the same point with each one of the paragraphs, and I found that to be true all of the way through.

MR. LERACH: I appreciate that the Court obviously spent, as you said, days, in going through the complaint and looking at the allegations, and then looking at what you characterized as the source documents, and obviously if you were deciding this case on the merits, it's clear you're going to decide it against the Plaintiffs.

THE COURT: Well, if this is all of the evidence I received, I would have to – no, not in favor of the Plaintiffs – in favor of Defendants.

MR. LERACH: I meant against the Plaintiffs and in favor of the Defendants.

But with the greatest of respect, I want to say to you that I think that the very approach that you follow – even though it took a great deal of time and I'm sure was very carefully engaged in – highlights the error of the Court's way.

It is simply not the Court's function at this time on a 12(b)(6) motion to look at this – I'm going to use the word

morass of information, but this mass of information and say, "After I have read all of these documents, I am persuaded" and you constantly used the word, "I don't see, the Court doesn't see", that you don't see a [p. 30] misrepresentation. That is not the purpose of the 12(b)(6) motion and it shows the folly of permitting Defendants to do exactly what they have done here.

Now, I understand, I believe that you are motivated by a desire to end what you believe to be an unmeritorious case early on, and I may disagree with you on that, but I understand in good faith, that's what motivates – probably your Honor here may motivate other courts, but we have a system set up of Federal pleading and in the Federal Courts of where a jury should make factual determinations and pleadings are to be respected, and with great respect this pleading does allege intentional or reckless fraud by the few Defendants that are named, it has allegations of insider selling, and it has allegations of a sudden revelation on April 3rd, not merely of an abandonment of a highly represented and promised expansion plan, but of the first earnings decline in the history of this enterprise since it became a public company, which resulted in the stock going down by about 15 to 16 points on 6,000,000 shares of volume in a two-day time period.

I think under those circumstances for the Court to conclude as a matter of law that there is no possibility that we can prove that the market price of this stock was inflated by the optimistic statements of the Price Company and analysts who relied on their information in the prior [p. 31] months, is simply a mistake.

Now, the Ninth Circuit has held in many cases, and *Duehring v. First Boston* (phonetic) is one of them that we cite the adequacy of disclosure is not a subject matter to be determined on a motion to dismiss, and that's exactly what the careful, painstaking, time-consuming analysis of the Court has done.

I have to take issue with the number of things that you said, and I do so – again I want to reiterate with great respect – nothing you ever read from ever said that the new stores were losing money.

THE COURT: Well, it's in there. I mean – I found it in a number of places – in a number of places.

MR. LERACH: I suggest to you that a statement that expenses of some kind or another are higher, or that sales are flat, or that interest – interest expense has gone up – or G&A, SG&A expense is higher than before, none of those are statements that indicate that the stores are losing money or Price Company's multi-year record of quarter to quarter earnings growth is in fact coming to an end, which is what was the announcement on April 3rd that really caused the stock to collapse.

In fact, Judge Brewster, a number of the statements that you read where words like "flat" or "even" were used with respect to profitability or profit margins, [p. 32] in fact, may well have been very misleading to the marketplace, because they suggest in using terms like "flat" and "even" the opposite of declining or losing.

Now, had this case been permitted to develop and go to trial, had the allegations of the complaint been accepted as true, and discovery permitted, an expert

would have sat on the stand there during trial and he would have testified to the jury that he had done the same analysis you had done. That he had looked at what Price Company said to the markets and the securities analyst said to the markets, and he had compared that to what the internal documents of Price Club said – assuming they say what we said they said, which you have to assume now.

And he would have said to the jury, "Yeah, there was some negative information in the marketplace; there were some risks there. In fact we know the stock declined from $65 a share to $48 a share during the class period, in large part because the market was in fact processing some of these risks and translating it into a declining stock price.

The market was aware in the spring of '92 that Price Company had cut the prices on some of its products. The market was aware of some of the other material you read from –

THE COURT: You mean – you mean spring of '91.

MR. LERACH: Spring of – no – or well, maybe [p. 33] winter of '92 – or January or February of '92 – I believe I'm right.

THE COURT: The spring of '93 – '92 is all over.

MR. LERACH: Okay. January – to be more specific – January and February of '92, I'm pretty sure there's a disclosure that the Price Company is cutting the prices of some of its merchandise, and the stock price is eroding, there's no question about that. That's not the same as the Price Club telling the truth that they knew

that the expansion program was in trouble. I think it is fairly discernible from the allegations in this complaint that the expansion program could not be maintained and that Price Club in fact was losing money on those new stores, and that its earnings were going to decline.

Now, that's what caused the stock to drop 15 or 16 points in a matter of hours on a horrendous volume of 6,000,000 shares. And a good expert – an expert in stock market behavior would have said to the jury, just as the treatises we cited to you say, that that kind of tremendously sharp drop off the edge of the cliff on huge volume only occurs where the market has been caught flatfooted, where the market is surprised, where something's been revealed that the market did not know, and that the price prior to that time had been inflated.

That's a decision for the jury to have made, it's [p. 34] not a decision you should make – with great respect – at the time of the 12(b)(6) motion.

Now, it's obvious that the Court feels that the case is not meritorious, so I don't think that it's going to be worthwhile for me to try to go through each of the paragraphs and do a counter-analysis to that which you have done. You've done the analysis, you've read the research reports and you've concluded that there is full disclosure.

But, your Honor, look at the fact that you have only three Defendants in this case, individuals, this is not a case where we sued an entire Board –

THE COURT: Let me – let me stop you. You said I've concluded that there is full disclosure. I'm not

sure that I have concluded that there is full disclosure. You have alleged that there was no disclosure, and I've concluded that that's not a correct – that isn't supported by the documents.

You say that – you say quote, on page 26 of your complaint, on line 11, you say, quote, "Which made no disclosure of any risks" –

MR. LERACH: Well, that may have been one document –

THE COURT: – well, that certainly leaves some problems, concerning Price Company's business, you know, and so forth. I mean, you're alleging that they were singing [p. 35] nothing but sweet tunes when they had problems.

MR. LERACH: That's an allegation as to one document. The allegation of the complaint overall fairly read is that these statements of Price Club and those of analysts for which it is responsible, presented an overall false and misleading impression as to the state of the company's business, the state of its earnings growth, the state of its expansion program. Judge Brewster, there is not a single public company in existence in America today as to which there is not negative information circulating in the marketplace as to which some securities analysts say "sell" and others "buy" and as to which people do not perceive risks.

That's not what the securities laws are about. There's risk in every investment, there's risk with respect to

every company. There's positive and negative information in the marketplace as to every company, every second of every day. The issue is whether these Defendants made statements which were either recklessly made or falsely made that inflated the market price of the stock.

With great respect that's what's alleged. It's alleged in a form and in a manner that's been sustained repeatedly by four score or more courts over the years, and I don't know what to say to you, other than, you know, we have to accept your judgment and your ruling, and –

[p.36] THE COURT: Well, for the time being maybe –

MR. LERACH: But you know, it's –

THE COURT: – there's another Court –

MR. LERACH: – a long life, and we may be back – and, you know, we'll see, but I just would reiterate – and again I'm not being critical, you know, Judge – I've appeared before you many, many times, and –

THE COURT: Don't be concerned about it. We're chewing over an issue here. I take nothing personally. I mean I have to – I have to do my job.

MR. LERACH: I know.

THE COURT: I have to rule.

MR. LERACH: You know –

THE COURT: One of you would be attacking me, and I expected it.

MR. LERACH: If I sounded –

MR. McMAHON: I would rather it be he.

THE COURT: Somebody apparently has already attacked you.

MR. McMAHON: And it wasn't fair –

MR. LERACH: As I sat and listened to your tentative ruling, and you went through each paragraph – those that you've covered and in painstaking detail said, "Well, this isn't exactly right" and I thought to myself, how inconsistent this is with the words in the cases that [p. 37] describe what's supposed to happen on a motion to dismiss.

How inconsistent it is with language that the complaint is to be liberally construed for the benefit of the pleader. How inconsistent it is with the notion that the complaint should not be dismissed unless it is clear beyond doubt that under no set of facts that are alleged, or could be proved based on the allegations, Plaintiff could recover.

Well, you know, recently we were up in Los Angeles Federal Court in a motion to dismiss in a case like this, and actually not as good a case as this and the complaint was sustained, and the Defense lawyer argued to the judge – Judge Gary Taylor – he said, "Judge, you know, there's a culture of dismissal with respect to these securities cases. These cases are the result of avaricious lawyers" he said, "dragging public companies into court to attack corporations. And a culture of dismissal has developed whereby courts very carefully – through the complaint to get rid of allegations that may not hold up later on, and a culture of dismissal has developed".

And Judge Taylor said to that lawyer, "Well, not under Rule 12(b)(6) it doesn't say anything about culture of dismissal". The Rules on 12(b)(6) are the rules and they should be followed, and the Court's approach is not consistent with 12(b)(6) and I guess that's all I can say.

[p. 38] THE COURT: Well, let me suggest this. Number one, there is no culture of dismissal – I'm not sure exactly what you mean by that – but there is no culture of dismissal in this Court, because I think that fraud, preying upon the public, and garnering millions and millions and millions of dollars is a very serious anti-social act by a company, and I don't have the slightest culture of dismissal against Price Club or any other club.

If the allegations of the complaint state the facts of which a Court could infer or a jury – any trier of fact could infer, that there is illegal conduct going on, then the complaint has stated a cause of action.

But the complaint has to allege a – you have to allege a gravamen of a cause of action, and what you're alleging is – you're alleging that the Defendants have said this, and they said this, and they said this, and they said this, and therefore we want to sue them.

And basically what the Defendants have said, "You're right, we have said this, and this, and this, and all of that is not only true but it's accurate and it doesn't hide the ball, and therefore, having alleged that we alleged this and this and this doesn't give you the right to recover any damages, because you haven't – you haven't alleged a cause of action against us".

That's their position and that's the context in [p. 39] which I reviewed the 12(b)(6). I am not trying to decide any merits – I'm just trying to see whether – and I think that the Defendant is entitled to have the Court read the complaint in the light of all of the cited material, because the public got the whole material, they didn't just get these quotations that the Plaintiff excerpted. The public got the whole publication – the third party publication – indeed, they got the whole Price Company's releases as well. They didn't just get excerpted paragraphs from them.

So the Plaintiff is stuck with what the Defendant said and did, and that's what the Plaintiff must win or lose on, what the Defendant said and did. And if – looking at what the Defendant said and did, the Defendant did mislead the public, did commit fraud, did hide the ball, and did fraudulently predict – in other words, fraudulently meaning we predict – we predict great growth, but in their heart they know darned well that that's not their real prediction. That's the fraud.

When you tell someone I predict that it's going to be here, if you sincerely believe that, you may be wrong, but that's not fraud. But if when you tell someone I predict it's going to be here and you don't even believe it in your own mind, and you're simply telling somebody that because you want them to act to their detriment on what you're telling them, that's fraud.

[p. 40] There is no showing that these predictions by the Price Club were not genuinely believed by the Price Club, and there is no showing that they did not warn all

the way through this whole class period about the difficulties that they were having and yes, there are portions in here which did describe losses, not just decreases in profits, and I'll – maybe we should take the time to find it, because I did find it. There definitely are portions in here which you allege, and which the Defendants have furnished the entire picture from, which describe losses in new warehouses. Not just the Chic Talwaga, or whatever that one in Buffalo is that closed, because that's obviously a loss, but I'm talking about in addition to that. In Buffalo they described warehouses which had initial losses.

MR. LERACH: Can I respond to one point? You say the public got the whole publication – referring to the securities analyst's report and the Price Company filings. That's right, they did get all of that information, and yet the stock went down 16 points –

THE COURT: Well –

MR. LERACH: – in a day of trading –

THE COURT: Well, don't you think –

MR. LERACH: 6,000,000 shares.

THE COURT: Don't you think that a corporate change of policy from one of expansion to one of curtailment [p. 41] – don't you think that would have a significant impact on the market?

MR. LERACH: Well, I guess I would ask don't you think the fact that the market collapsed that way indicates that the market was not aware of the fact that Price Company's earnings were going to be significantly

lower than historically their trends would have suggested and their statements suggested?

THE COURT: But each quarter, each quarter, and it's alleged here. The Price Club turned over their earnings record. They showed how they were – in fact, one of them – it went up two cents a share – and they described it as pretty sluggish growth, and the company acknowledged that. They said, "You're right, it is sluggish because we've got these expenses, we've got these new warehouses coming in, and we've got a recession going on here, folks. We've got bad markets, we've got a tremendous amount of competition, Wal-Mart and Cosco (phonetic) and all of these other discount warehouse businesses that we're competing with, and yes, the growth is sluggish and we're struggling, we put in the Reinvestment Trust because we think we can maximize the return if we use our own money rather than go out in the market to borrow money for our plants" and they were following what they thought was good management decision making to keep this company growing.

[p. 42] The third quarter, the quarter just before April of '92 they had slight earnings growth, but the last quarter, boom. Now, you can't say that they are legally liable for not having earned money. That's not a legal liability. They can't be held liable for that.

MR. LERACH: No, but they are liable for saying – if it was false as we allege it was false – that the expansion program was working so successfully that it provided the basis for solid dependable growth in the future, when, in fact, that's not what was happening –

THE COURT: Well –

MR. LERACH: That wasn't true –

THE COURT: – they said, they –

MR. LERACH: – and that's why the stock collapsed.

THE COURT: Mr. Price said that – Mr. Price said a number of times that, "We hope that you will look toward the long term with this company. We have present problems. We think that the expansion problem ultimately will redeem itself, but you've got to look for the long term".

That's mentioned two or three times in his shareholder's letters and I remember reading them verbatim right out of the letters.

Maybe – now, maybe it would be – if it's the desire of either of you to go right down through each one of [p. 43] these paragraphs and put into the record the quotations which the Court was noting in analyzing this motion, I'm happy to do it. It's an important case. I know that it involves a lot of money – the Plaintiff is suing for millions – mega-millions of dollars – a hundred millon [sic] here, a hundred million there, pretty soon you're talking big money.

MR. LERACH: I just wanted to make one point. One of the statements he makes is, "We're more optimistic about our near term future, as well as long term".

THE COURT: Which date – what date was that statement?

MR. LERACH: I'll find it for you.

THE COURT: While you're finding it for me, you mentioned insider trading. As I recall, those two trades occurred around June or so of 1991? That's about nine months before the thing came unraveled, and they sold – presumably two directors sold a percentage of their holdings – nobody else sold anything.

I mean, if there were a plot – if this were a fraud being perpetrated by a bunch of fat cats on the Board of Directors, you would see a bunch more of them – coming around January or February – you would see a bunch more of them bailing out and getting their money out of that company before the thing turned sour in April, which you don't.

[p. 44] MR. LERACH: Well, your Honor, with great respect, where does that come from the complaint? We only sued the people who sold stock. How can you look at what people who weren't even sued did and draw a negative inference to us from that.

THE COURT: Are you telling me – are you telling me that more Directors bailed out?

MR. LERACH: I didn't say that –

THE COURT: Well, if you –

MR. LERACH: – but what I did say –

THE COURT: I inferred that if they had, if you had been alleging it –

MR. LERACH: But that's not in the complaint, and the two people who sold, by the way, one of them sold in February of '92, as well as May of '91. One of them

sold more than half his holdings, and one of them, apparently, sold all of the stock he acquired by option during the class period. I suggest to you –

THE COURT: That's right – that's right. They did sell – not in one day. They didn't go out and dump. They did sell a number of times, I guess one of them sold five or six times, and the other one sold a few times, too. And they did sell over a period of time, and they sold mostly option stock.

You know there is no connection – timewise there [p. 45] is no proximity between those isolated incidents and any – and any statements made by the company or anything else. It just – they are just isolated events that are just thrown out into the complaint.

MR. LERACH: Well, as I say, your Honor, we respect your view, and –

THE COURT: Well –

MR. LERACH: – let's proceed – help somewhere else. But anyway, it's a pleasure to appear before your Honor and I do appreciate that – I know the Court took a tremendous amount of time and effort to review all of the –

THE COURT: Let me call your attention to – you remember I read to you the part where it said that you alleged in paragraph 30 that the company made no disclosure of any risks, uncertainties or problems concerning Price Company's business which made it reasonably likely that Price Company history of earnings increases could not be continued?

MR. LERACH: In that 10-Q, yes.

THE COURT: And that was on April 29, 1991, and you allege it again in the July 1991 – in that report you once again allege that "that report made no disclosure of any risks, uncertainties" – I'm reading from paragraph 33 now.

MR. LERACH: Right.

[p. 46] THE COURT: "Made no disclosure of any risks, uncertainties or problems concerning Price Company's business, which made it reasonably likely that Price Company's history of earnings increases could not be continued".

That's – I take it those are the two shareholders' statements in their reports –

MR. LERACH: Their 10-K –

THE COURT: Two 10-Q's following each of the quarters that they filed them.

And those 10-Q's do disclose risks and uncertainties and problems. I mean, to say that they make no disclosure is simply not accurate, it's not a fair allegation.

MR. LERACH: I just respectfully disagree with that, and the –

THE COURT: Well, take a look at 33. Look at your paragraph 33. Let's look at the 10-Q dated July 19, 1991.

It's in the declaration, Tab 33, as found in Exhibit 4 – I mean page 4 of Exhibit A. That's the 10-Q that we're referring to. And if you look at that 10-Q it says "gross" – page 7 of that report describes "gross margin decreasing during the third quarter of '91, fiscal, compared to the

same period of prior years. This decrease is primarily due to lower gross margins for Canadian [p. 47] warehouses and is partially offset by a slight increase in gross margins for U.S. warehouses, and increase in sales activity of other business, i.e., so forth".

And then the next paragraph, "Selling, general and administrative expense has a percentage of sales increased" – I think I may have read this earlier. I read one similar to it.

MR. LERACH: Well, they have the same language in virtually every 10-K.

THE COURT: Yeah, they – every report they come out with they do identify problems and risks and disappointments, and on page 8 of that same report it says, "The increases in goodwill and merchandise inventories from August 31, 1990 to June 9, 1991 are primarily due to the consolidation of Price Club Canada. The increase in property, plan and equipment from August 31, 1990 is due to both purchases of property and equipment related to the opening of new warehouses and the consolidation of Canadian property, plan and equipment".

They are telling about all kinds of problems they're having all the way through.

Then it says on page – I read that one already. The quote on paragraph 34 – that's the 10-Q – no, paragraph 34 is the Weirheim Schroeder report, and that appears in the supplemental declaration, and that's Tab 3 of [p. 48] Exhibit A, and there are all kinds of problems. It says – in fact if you look at the bottom paragraph it says, "Comp warehouse sales have improved slightly on the East

Coast, but as yet there is no significant change in the trend. Earlier the sharp slowing of these sales increases was mainly due to cannibalization of Price Club's Fairfax, Virginia unit by new units in Gaithersberg – Maryland and – Virginia. Fairfax sales are now starting to recover and as of late July the cannibalization from Gaithersberg was anniversaried".

And 35 – 35 that's the declaration. This is not Price Club talking now, this is Alex Brown & Sons again. Tab 35 is – I mean paragraph 35 is found in the declaration and it's Tab 2 of Exhibit B, and right off the bat it says, "Sales trends in light of expectations", it says – the second line – "While current comp warehouse sales trends remain below the industry average we believe that the addition of new units such as meat and bakery into the warehouse will have a positive effect in comparison. Additionally, we believe" – now, this is not Price Club talking, this is – this is Alex Brown – good for them – they believe that intentional cannibalization of existing Price Club units by newly added locations has had a dampening effect on the comp warehouse figures as have weak economic conditions in California where the bulk of Price [p. 49] Clubs are located. As the company begins to anniversary cannibalized units, comp warehouse sales should improve".

That's the – that's the source of paragraph 35. It wasn't quoted by the Plaintiff, but it certainly bespeaks of problems and cautions and slumping market, and it says the bulk of Price Club is located in California where weak economic conditions prevail.

Then paragraph 36 –

MR. LERACH: Of course, I would just like to point out one thing in that. The expansion was outside of California in a large part. That was sort of like the whole point of it.

THE COURT: Sure, that's right, but –

MR. LERACH: See, and they were saying to the market –

THE COURT: – but they reported –

MR. LERACH: – we're expanding outside of California, and that's where the growth is going to be.

THE COURT: However they were still reporting that the sales trends were below industry average, and that – that their weak sales, they hoped, were going to increase in the future. But they are telling you right now they've got problems.

MR. LERACH: But where does it say the new stores are losing money?

[p. 50] THE COURT: Well, I'll find it. I haven't found it yet, but I did see it, and I'll find it.

Thirty-six, that's a Price Club report to the public on August 8, 1991 and that's in the declaration. That can be found on Exhibit 5 and Tab 5 to Exhibit A, and that's the press release.

Now, this is the press release concerning the real estate investment trust, and that really doesn't directly impact the issue of the lawsuit. It's a totally true statement – it just tells them about the proposed offering of

the trust certificates for that Real Estate Investment Trust. So that really is kind of an idler – that's an idler gear in the complaint, it doesn't do much one way or the other, just states a fact.

Thirty-seven is – in fact it's in the declaration and it's found in Tab 3 of Exhibit B, and this is Alex Brown again, research company in stocks and bonds on – and you notice on page 2 it shows – on the second paragraph under that first dot – "Fiscal year 1992 warehouse expansion projection appears conservative".

Look at the second paragraph, it says, "The 10-unit increment to our expansion projection" – that's theirs, not Price Club's – "for fiscal year 1992 could add as much as 400 to 500 million to our 7.5 billion revenue estimate for the year. While these additional units would [p. 51] not materially add to earnings in the fiscal year 1992, the potential accretion to our fiscal year 1993 estimate could be as high [sic] .25 per share based on the 800,000,000 in volume" and so forth.

This is a projection that Alex Brown is making, not the Price Club, but the point that I'm reading from to get the point to you, is that they are conceding that these new warehouses are not going to materially add to the earnings in 1992. That point is made repeatedly. That's made throughout – these new warehouses, because of the expense of coming on line, they aren't going to add much to the income stream.

Look at paragraph 38 of the complaint. This is Wertheim Schroeder's analysis, and that's in the supplemental declaration, and it appears on Tab 4 of Exhibit A, and you will notice that – this doesn't concern sales. Tab

38 – paragraph 38 is once again a discussion of the reinvestment trust. There is no – the Plaintiffs aren't claiming anything fraudulent about the reinvestment trust so I regard that paragraph as kind of an idler. You're bringing in an interesting fact, I think, just to complete the picture, which I don't criticize at all, but that's all that exhibit and paragraph concerns.

Paragraph 39 also concerns –

MR. LERACH: Could I just say one thing so you [p. 52] understand? What Price Club said about the REIT offering was that the money that came from that that would ultimately flow to Price Club would be used to fund the continued expansion program. The market interpreted that very positively, as a concrete affirmation that the company's expansion plans were intact and going to go forward.

THE COURT: Absolutely. Now, but you don't allege that they didn't do that.

MR. LERACH: We most certainly alleged that they knew throughout the class period this expansion program was doomed, that it was not working –

THE COURT: You don't –

MR. LERACH: – and it would have to be abandoned. Well, I think we do.

THE COURT: Where do you allege that?

MR. LERACH: Well, it says, I think, in paragraph 59, "Price Company was experiencing consistent losses in almost all of the new units which it had opened during the class period, which made it probable that its

expansion program would not produce the benefits which had been anticipated and would have to be curtailed or abandoned".

Paragraph 51 – 59-P says, "Price Company was aware of the adverse facts set forth above".

THE COURT: Which – which paragraph were you reading from?

[p. 53] MR. LERACH: I was reading from paragraph 59.

THE COURT: I know, but what page and what line?

MR. LERACH: I'm sorry, it's line – it's page 49, and lines 4 through 8. Also lines 9 through 14 are a variant of that allegation.

(Pause.)

MR. LERACH: Page 51, lines 4 through 7 is another variant of that allegation.

THE COURT: All of these – all of these allegations in paragraph 57 – or excuse me – 59, rather – all of these allegations in 59-A through – it goes all the way up to –

MR. LERACH: S.

THE COURT: – S. Basically what you allege here is the difficult process of bringing on new – new warehouses into the profit stream. You do allege in a couple of these that the – that almost all of them that were brought on the line during the class period were losing money. You allege that on – where was it again?

MR. LERACH: Well, paragraph B, page 49 clearly alleges that.

THE COURT: Paragraph B. "Was experiencing consistent losses in almost all of the new units which had opened during the class period".

Now, there was nothing that I found in these [p. 54] documents in which the Price Club identified that it was losing money – profit versus loss – said it was experiencing loss on almost all of its new units that it opened during the class period. I didn't find the documents – so you might make a note, Mr. McMahon, that you might want to address that. Maybe I've missed it, maybe it's – because I didn't find any document in here in which each of the branches – each of the warehouses was identified separately and its profit or loss identified separately. Is that in here and I missed it?

MR. McMAHON: I don't think so, your Honor, nor is it required to be.

THE COURT: Well, if it was in one of the documents which the Plaintiff cites to, then – your theory of the case is if the Plaintiff cites a document and if in that document exculpatory material is there, the Defendant has a right to call that to the Court's attention.

All I'm saying is that I didn't find in any of these documents, which were in your declaration or your supplemental declaration, any document which the Plaintiffs have referred to in which each of the warehouses was identified and exposed as making a profit or a loss.

MR. McMAHON: And I think that's correct.

THE COURT: If it's in there, I missed it.

MR. McMAHON: I don't think they go warehouse by [p. 55] warehouse and give a warehouse by warehouse report. Instead they report on company-wide operations and the documents point out very clearly that the new warehouses, as everyone would expect, are a burden on the profitability of the company –

THE COURT: That's true.

MR. McMAHON: – it does say that. They also say that the reasons for that are that in some cases the Price Company is going into new areas where they are not as well known as they are in California, so they have to deal with competitive factors in the new areas, and when they're going into areas where they are known, they speak in the reports about cannibalization, which we know from the Navy is a term for when they take parts from one airplane and put them into another airplane to keep them flying –

THE COURT: Well, I followed the cannibalization. I don't know what anniversary means – I don't know what that means.

MR. McMAHON: I don't want to try to –

THE COURT: I think we had cannibalization in San Diego when they put a new – when they put a new warehouse in out there in Rose Canyon –

MR. McMAHON: Sure.

THE COURT: Right next door to the earlier warehouse and then they just kind of moved next door, and I [p. 56] assume that that's an example of cannibalization.

MR. McMAHON: Right, and when they opened up the very first warehouse on Morena Boulevard – they then opened up a second warehouse –

THE COURT: That's the one I'm referring to, when they opened –

MR. McMAHON: – well then a third one in another area of San Diego, and obviously some of the people who would drive from, let's say, Chula Vista to Morena Boulevard would not go to the Morena Boulevard store and the Chula Vista store, let's say, was the one where that person would trade.

The point is that the company and the analysts as well, in describing what was going on, were describing frankly, the obvious, that is, where you open up a store in an area where the Price Company is not known, and you're going up head to head with a Wal-Mart or Cosco, you have competitive problems. They talk about that, and I think the term "burdening the profitability of the company" is used.

THE COURT: They speak of that all the time.

MR. McMAHON: In addition they talk – I believe – in the annual report of 1991 fiscal year. "Furthermore, several of the new locations opened in 1991 will still be young – too young – to affect sales and earnings significantly, and the rapid expansion plan for 1992 will [p. 57] result in increases in expenses before the benefits are realized".

Well, Plaintiffs would like you to write your reports exactly the way – in hindsight – they would like you to

write them, but the human mind must come to one conclusion when you read "increases and expenses before benefits are realized" is that we're building for the long term – we're obviously going to have some losses as new stores open up.

We also report over the class period about stores closing. We report on disappointments in certain areas. There is no requirement, your Honor, that you list a store by store profit and loss. Indeed, part of this is disclosure to your competition. Wouldn't it be nice for Wal-Mart to know exactly what each of our stores was doing in each location. Is that what the Plaintiffs would have us do? Is that a benefit to our shareholders who they purport to represent?

I think the Court has analyzed this matter entirely properly, just the way the complaints were analyzed in a large number of cases that we have cited, and you even go beyond the actual documents themselves.

We have a fraud by hindsight case here. The stock dropped – of course the stock dropped. We weren't required to predict what the earnings would be for the fiscal year – [p. 58] second quarter of 1992. We are not required to predict – we're required to accurately report, and we did that. And sure the stock dropped in price, because the second quarter of the fiscal year '92 was the first quarter in the history of the company when the stock had not increased – the earnings had not increased per share from the comparable quarter a year before. That in and of itself would be a significant matter one might postulate. Well, we're not required to predict – we're required to report, and we did that.

Counsel really has not cited anything that changes the basic problem with this complaint – or really problems – plural. Problem number one is that they don't really fairly state what the documents upon which it relies state.

Problem number two is – what they do is they – in conclusionary fashion – try to allege, particularly in paragraph 59, that this company did everything possibly wrong that a company could do wrong with the hope that this would become a passport to discovery at enormous cost and expense to the company, in the hope that they would find something to support these allegations, because the allegations are not sufficient to pass muster under 9(b).

For example, they toss in something about an accounting system. Well, they don't tell us anything specific about the accounting system being inadequate, they [p. 59] just toss that in there. 9(b) says you can't do that.

So the documents themselves don't support the complaint. The documents themselves bespeak caution. We don't have to predict things. They don't say – and they really can't say – that we didn't honestly believe what we were doing with respect to the company. At most they are trying to allege negligence, and mismanagement, and Santa Fe Industries tells us that that won't fly, and though the complaint is very long, it's very short on specifics that 9(b) requires. Who, when, what, how, was this massive fraud allegedly conducted.

This complaint is not sufficient to be a passport to costing this company enormous sums of money in discovery and to try to defend itself. It's just not adequate, and I

submit the Court has done an – a quite proper and thorough job in exposing the deficiencies.

THE COURT: I'm – I still feel bad that – I told you that I saw in here the reports of losses, and I was trying to find it for you because I was sure that I had seen in it, but there's so darn many exhibits that I – now, I'm trying – now I'm looking for a needle in a haystack.

All of these exhibits have very guarded, cautionary discovery type remarks in them. But what I'm specifically looking for now are where they specifically describe a loss – for example on – this is Exhibit – this [p. 60] is Exhibit 3, Tab 7 to Exhibit B of the declaration which applies to paragraph 49 of the complaint, and on page 2 of it it says – the top paragraph, it says, "Overall management confirmed our assumption that 16 to 17 new units will be built next year, and suggested the company may accomplish a similar expansion in '93. While fiscal year '90-92 openings will burden company-wide profitability, we believe that these newly added units will provide significant earnings leverage for the fiscal year 1993".

But this lawsuit was drawn before we ever even got into fiscal 1993 – I mean – the class period stops the music before we even find out what's going in 1993, and I haven't any idea whether –

MR. LERACH: Actually the complaint pleads what happened in the balance of '92, and in the balance of '92 contrary to the representations of long-term growth made by the company – solid dependable growth – the company has continued to report declines in operating earnings.

THE COURT: And I'm sure that that's related to their change in their policy from expansion to curtailment. I mean –

MR. LERACH: I think it's related to the losses they have suffered on the new stores that they opened.

THE COURT: The problem is you quote these 10-Q's that come in every quarter, and the earnings are very [p. 61] sluggish, but they are always slightly on the increase, and it wasn't until the April 1992 quarterly report that ended March 17, and all of a sudden they had – I think it was 13 cents a share drop in earnings – that's the first drop in earnings.

So they – and your theory is that they had all of these losses going on for over a year – for a year and a half – and yet in the face of that they were reporting slight, slight, sluggish increases in the overall earnings, and then all of a sudden, boom, they had a 13-cent drop.

Now, that couldn't be related to a pattern of consistent losses that – in their plans for more than a year previous. You wouldn't – you wouldn't have that kind of a balance sheet. This didn't all of a sudden happen – it doesn't explode like a bomb. I mean, it rather grows –

MR. LERACH: How does your Honor know that the decline in earnings was not due to write-offs they took because they closed unprofitable stores that had been accumulating all during the class period. The very losses – the only losses we claimed they knew about, but didn't tell the public –

THE COURT: They told us about unprofitable stores they closed. You don't allege that any others were closed.

MR. LERACH: I reiterate my view. The Price Club never disclosed that the newly opened stores – ones that [p. 62] were actually opened and in business – were suffering substantial losses. They simply did not disclose that. And it was those losses that resulted in the curtailment of the expansion program; they knew it during the class period; they never disclosed it, and when it came out, the stock collapsed because instead of a company that was building a base for solid dependable future growth, which is – of course, the sentence Mr. McMahon left out of the annual report when he read it – the last sentence is, "Nonetheless we expect to turn in a solid performance and believe that we are currently setting the stage for solid dependable growth in the future". He didn't remember to read that statement on December 5, 1991.

THE COURT: Well, that's not an actual statement. I mean, if he – unless he didn't believe it.

MR. LERACH: And it's alleged he didn't believe it.

THE COURT: It's alleged he didn't believe it?

MR. LERACH: It is, your Honor, with –

THE COURT: Where?

MR. LERACH: It's in the complaint. It says they knew those statements were false and misleading. It says that in the complaint.

THE COURT: The statements that you're quoting from are their predictions about what's going to happen in [p. 63] the future.

MR. LERACH: That is a forecast made by Mr. Price –

THE COURT: Yeah, it's a –

MR. LERACH: – on December 5, 1991 which we allege was contradicted by adverse facts known to him and not genuinely believed by him, or the other Defendants. I mean that's what our pleading is.

(Pause.)

THE COURT: I keep running into these statements about new warehouse additions. "Burden, operating profitability as expected. The addition of 10 immature warehouses to the unit based burdened operating margins, as expected. However, as these newer units age we expect operating margins to expand".

That – I'm not relying on that. I thought I saw a statement of losses, not just burdening profitability. They keep mentioning this Chic Talwaga Buffalo warehouse closing.

MR. McMAHON: Your Honor, I think that you will find on, for example, the January 14, 1992 letter to shareholders –

THE COURT: What exhibit – what paragraph of the complaint does that relate to?

MR. McMAHON: This is – first, I'll tell the [p. 64] Court where the document is. It's in the supplemental – it's in the May 12, 1992 declaration, exactly.

THE COURT: This – the declaration? Okay, and what –

MR. McMAHON: Tab 9.

THE COURT: Tab 9 of Exhibit what?

MR. DELPHEY: A. Exhibit A, Tab 9.

THE COURT: Tab 9, Exhibit A?

MR. DELPHEY: Right.

MR. McMAHON: This is about two-thirds of the way through the class period.

THE COURT: Okay, just a minute, I've just about got it. Tab 9 – okay, I've got Tab 9 of Exhibit A.

MR. McMAHON: It's the January 14, 1992 letter to shareholders.

THE COURT: Okay. Okay.

MR. McMAHON: And the third from the last paragraph says –

THE COURT: I see it. "We anticipate that it will take time and expense to achieve profitability, because of comparable – competitive conditions and a comparatively low awareness of the Price Club".

MR. McMAHON: If it's going to take time to achieve profitability –

THE COURT: And it tells you that –

[p. 65] MR. McMAHON: – it does not require a rocket scientist to conclude that they are losing money.

MR. LERACH: Judge, can I say something?

THE COURT: Yes, sir.

MR. LERACH: We're not supposed to be detectives. They are the ones with the obligation to tell the truth.

First of all, that statement refers to stores that weren't even yet opened, and if you read it fairly you will see that. That's a very misleading argument they make.

THE COURT: Stores that weren't even open?

MR. LERACH: Were not even opened.

THE COURT: Well, how could they be profitable or unprofitable if they weren't even doing business –

MR. LERACH: That's my point. It doesn't have anything to do with what we're alleging in this case. That refers to then planned openings in Philadelphia, Dallas, Houston, Mexico City and Chicago. Stores that weren't yet even opened during the class period. That statement doesn't have anything to do with what we allege in this complaint.

THE COURT: No, except they are warning that these new stores aren't even expected to reach a profit when they come on line.

MR. LERACH: And that's great, and that stores they are opening somewhere else – that has nothing to do with stores which – some of which have been open for months [p. 66] and which they did not disclose were losing money and your Honor I want to repeat this.

The obligation to tell the truth clearly and in a straightforward manner is that of the public company. The investors aren't supposed to be a bunch of Sherlock Holmes' running around with a magnifying glass, going through statements the way that we've gone through them today to try to figure out what that might mean, or might suggest, or what the nuance is. These are the guys who are walking around talking about solid dependable growth in the future, being enthusiastic about the expansion program and making all kinds of positive forward looking statements. They have an obligation to be just as direct, just as direct and candid about what the problems were and about the adverse information they were concealing.

(Pause.)

MR. LERACH: You want to hear the statement from the January 14 letter. It reads, "The company plans to open at least eight and perhaps as many as 10 additional Price Clubs before the end of this fiscal year, August 31, 1992. We are enthusiastic about the opportunities in these metropolitan areas, but anticipate that it will take time and expense to achieve profitability because of competitive conditions and comparatively low awareness of the Price Club".

[p. 67] That has nothing to do with the stores that were already open.

MR. McMAHON: It just echoes what they have been saying for the last three quarters, quarter after quarter. It just echoes that.

THE COURT: This is perhaps a little bit of a velvet hammer, but they say in paragraph – the complaint's paragraph 50, which is in the declaration, the Price Club report which is dated –

MR. LERACH: I mean there's a statement in the 1991 annual report that comes out right before that. "This pace of expansion" – he's talking about their program – "is the most aggressive in our history and I am comfortable that we have the people and systems in place to accomplish it successfully".

In fact, the complaint alleges the expansion program at that time was a complete failure, was losing money, and they knew they were going to have to abandon it or curtail it. I just don't know how a statement could be more false than that statement, based on the allegations of this complaint, or more material to the securities markets given the position of this company.

THE COURT: August 1991, but they still had increased earnings for two and a half – for two quarters after that date.

[p. 68] MR. LERACH: This is a December 5, 1991 statement.

THE COURT: Oh, okay. And that quarter – they were – they had all – right up to the time of their statement they were having increased – very slowly increasing sales per share.

MR. LERACH: As a whole. The corporation had 77 stores out there. The focus is on the new stores that had been opened that were much ballyhooed as the great

success of the future which would be the expansion program. Those stores were losing money, they knew it, they knew they were in bad locations, and by the way, we don't say anything about cannibalization in this complaint. I want that clear in the record, that's a total red herring.

These were new stores in new areas where there weren't existing Price Clubs – cannibalization has nothing to do with this, Judge Brewster. I mean, they are just trying to grab any statement they can find that's the least bit negative about the company and pretend that it discloses the things that we say were not disclosed during the class period.

THE COURT: Well, you know in this report that they made in December – August 31, 1991 – this is the – this is the exhibit that pertains to the complaint – in paragraph 50 of the complaint.

This is the report of August 31, 1991.

[p. 69] (Pause.)

THE COURT: They have a lot of cautionary language in this, Counsel, that really is the – it's what I regard as a non-actual – by the Defendant. It's in the paragraph called "future trends", and this is where they give some cautions and they identify risks toward the future.

For example, they say in the second paragraph, "Increases in comparable warehouse sales. As a percentage of the prior year sales become more difficult to sustain, as the base number of warehouses increase, as existing warehouses mature, or new warehouses are

opened, in the same broad market area as an existing warehouse. The company believes that its ability to continue to experience growth in comparable warehouse sales in the foreseeable future will be affected by the current recessionary economic conditions, especially in California, where a significant portion of the business is operating. In addition, the relatively high average volumes per warehouse made year-to-year increases more difficult to achieve" and jumping down two paragraphs, it says, "The company increased its rate of new warehouse openings in '91 and has announced a desire to continue this increased level of expansion the coming year. Future expansion will continue to be limited primarily by the company's ability to maintain tight management control over operations, availability of sites, potential saturation of [p. 70] market areas, existence of direct competition in market areas, continued acceptance of the Price Club concept, and general economic conditions".

And this is language by the Price Club that bespeaks of caution, bespeaks of risk, bespeaks of putting people on notice that – like you say – every risk – every investment is a risk, and the Price Club is recognizing that, and they're not denying it.

In keeping – on page 11, continuing that same report, it says that, "The company expects that fiscal '92 will likely to be a continued year of building for the future – for the future. The California market, the company's most important, seems to be pulling out of the recession less dependably than other areas of the country, and the company will be affected. Furthermore, several of the new locations opened in '91 will still be too young to affect

sales and earnings significantly. The continued expansion plan in '92 is expected to result in increases in expenses before their benefits are realized. Nonetheless, the company believes that it is currently setting the stage for sales growth in the future".

MR. LERACH: That's false. "Too young to affect earnings significantly" – they were losing money. They were affecting earnings significantly, that's the point. That statement is calculated to mislead, not inform.

[p. 71] MR. McMAHON: Your Honor, the –

MR. LERACH: If that statement did nothing more than suggest those stores were at a break even level and that's not what it suggests, it would be false and misleading.

MR. McMAHON: Your Honor, may I just say where I think Counsel is kind of grossly off the track at this point?

Here is the problem. The Price Company didn't sustain a loss as a company. The second quarter of fiscal year 1992 did not earn as much as the second quarter of fiscal year 1991. The company did not sustain a loss.

What they were doing was bringing – and it's clear from the documentation – they were bringing on new stores – they were telling the public what the problems were, that those new stores were burdening profitability. That the expenses related to the new stores were not yet being justified by benefits accruing from the new stores, but there is no dispute in the case that the company continued to make a profit.

There is no requirement, and Counsel has cited to no requirement – that the company list the individual store by store results. That is private information that competitors should not be able to see.

The company said time and time again in the [p. 72] documentation that the new stores were burdening profitability. The analysts said the new stores were burdening profitability.

What Counsel really wants to have us say is these particular stores lost this much money. Well, I submit that that's not required under the securities laws – it's not required under the reporting that is done quarterly by the companies, and when the second quarter of fiscal year 1992 was over, the company reported the results of operations for that quarter. A 20-plus million dollar profit. It just wasn't as large as the profit had been a year before that.

There is nothing wrong with doing that, and there's nothing in this complaint which alleges within the requirements of 9(b) that the company at any time, or the individuals at any time before they reported it, were aware that the profits from a company-wide standpoint were not going to be as high as they had been for the comparable quarter a year before.

This complaint is fatally deficient because it attempts to allege, in conclusionary terms, that the company officers failed to predict, and they are not required to predict. Indeed any time – if you take the logic of what I'm hearing – any time a company stock dropped significantly, a Plaintiff could come into court and allege that this catalog of potential reasons for the drop existed, [p.

73] and that everybody was fraudulent over on the company side, and put the company through a massive lawsuit, while they hunt around seeing if they can find any support for those allegations.

That's not the way it's supposed to be. This is not supposed to be a – file a complaint and then try to go do discovery to find fraud. It's just the other way around, and not only are the disclosures adequate here, but the allegations of the fraud are inadequate, and we submit, because these people certainly know what they're doing, this is their business, that they have done the best they can, and it just isn't enough.

THE COURT: I just want to finish reading from this exhibit that I was reading from – Exhibit to the complaint, paragraph 50 – I was reading from that Price Club statement. It's dated August 31 of 1991, just to complete what I was reading from.

It says – in the last paragraph, next to the last paragraph, it says – "To some extent of course, the company's future growth will be affected by general economic conditions, consumer preferences, the activities of the company's competition, and other factors beyond the company's controls. Such factors may affect the company, either beneficially or adversely"

The Plaintiffs – the class Plaintiffs – bought [p. 74] stock in the company. It's the profitability of the company which is the issue here, not the profitability of any particular line of merchandise that they are selling, or any particular warehouse that's selling. In other words, it's – it's as inappropriate, I think, to allege a loss of a warehouse when you're really – you're really arguing the

profitability of the company – as it is to say that bakery goods sales were operating at a loss within a particular warehouse. You look at the whole warehouse, not the bakery goods, and you look at the company, not the particular warehouse.

The profitability of the company is the Plaintiff's complaint, and I just – I just have to conclude that – I think that the company went well beyond what the law requires. If the drop in stock of a company, which happened in the case of Price Club – if that brings a liability under the Securities Act, then it would be a strict liability in securities. If it goes down, the company is liable. Now, if it goes up, the company doesn't have a cause of action, I guess, against the shareholders to give the profit back to the company, but if it goes down, the company owes the money. I don't think that's the law.

There isn't any – there isn't any sufficient allegation of fraud here. There is no sufficient allegation of 10(b)(5) violations – I just can't – I can't conclude [p. 75] that the complaint states a cause of action under any of the causes of action against Defendant, and I'm not going to require the Defendant to answer.

Now, this is the second time we've had the go-round – I imagine that you will concede that the Plaintiff's Counsel is probably the best in the country at these kinds of matters, and I don't know what benefit we would gain by giving you another swing at the pinata, but I think the best thing to do is to – if you think that the complaint – and I know your position, Counsel, is that your complaint states a cause of action, and that you are entitled to command an answer from the Defendants, and I know

that's your position, and if you're right, then you should have an opportunity to require that they answer that complaint – perhaps the best thing to do would be to just grant the motion to dismiss under 12(b)(6) without leave to amend, and then you'll have a shorter record to go upstairs on.

MR. McMAHON: Thank you, your Honor.

THE COURT: Fine, and –

MR. McMAHON: And 9(b), your Honor.

THE COURT: And 9(b), right. The fraud counts, as well.

Now, would you – Mr. McMahon – would you draft a proposed answer and have it approved – or a proposed order [p. 76] –

MR. McMAHON: Yes, does the Court also –

THE COURT: – and have it approved as to form, if possible?

MR. McMAHON: Yes. Is the Court also, of course, dismissing the Defendants' estate [sic] claims?

THE COURT: Yes.

MR. McMAHON: Thank you.

THE COURT: And can you get us an order within 10 days, and have it approved as to form, if you can –

MR. McMAHON: Yes, sir.

THE COURT: – and then we'll take a look at your order.

MR. McMAHON: Thank you, your Honor.

THE COURT: And thank you both.

MR. McMAHON: Thank you for your time.

THE COURT: For this Court, that didn't do securities work, it was not an uncomplicated matter, but it was very interesting, and I did spend a lot of time on it, but it was enjoyable, and I had to rule against somebody, and that's the way it goes, but that's the best I can do.

MR. LERACH: Nothing personal, your Honor.

MR. McMAHON: Thank you, your Honor.

MR. DELPHEY: Thank you.

(Proceedings concluded.)

[p. 77] I certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter.

/s/ Adeline Carlson — 4-6-93
Transcriber — Date

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO and JOSEPH LASENSKY, On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, v. THE PRICE COMPANY, ROBERT PRICE, DENNIS ZOOK, and TED WALLACE, Defendants.	CASE NO. 92-497-B (BTM) ORDER GRANTING MOTION TO DISMISS SECOND AMENDED COMPLAINT WITHOUT LEAVE TO AMEND AND JUDGMENT OF DISMISSAL

On March 9, 1992, the above captioned matter came on regularly for a hearing before the Honorable Rudi M. Brewster. Gerald L. McMahon, Esq. and James P. Delphey, Esq. appeared for defendants; William S. Lerach, Esq., Dennis J. Stewart, Esq. and Robin R. Williams, Esq., appeared for plaintiffs; Howard Finkelstein, Esq. also appeared for plaintiff Joseph Lasensky. Upon the Court's consideration of defendants' motion to dismiss Plaintiffs' Second Amended Complaint, the briefs and other papers submitted in support of and opposition to this motion, papers filed in connection with defendants' previous motion to dismiss plaintiffs' First Amended Complaint and the oral argument made to this Court, and based on the Court's review of the Second Amended Complaint,

IT IS ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

(1) Defendants' motion to dismiss the Second Amended Complaint is granted without leave to amend under Federal Rules of Civil Procedure 12(b)(6) and 9(b);

(2) This action is dismissed on the merits with prejudice; and

(3) Defendants shall recover their costs of action.

DATED: Mar. 18, 1993

/s/ Rudi M. Brewster
UNITED STATES
DISTRICT JUDGE

SUBMITTED BY:

/s/ James P. Delphey
Gerald L. McMahon
James P. Delphey
SELTZER CAPLAN WILKINS & McMAHON
Attorneys for Defendants

APPROVED AS TO FORM:

/s/ Dennis J. Stewart
William S. Lerach
Dennis J. Stewart
Robin R. Williams
MILBERG, WEISS, BERSHAD
SPECTHRIE & LERACH
Attorneys for Plaintiffs

UNITED STATES DISTRICT COURT

Southern DISTRICT OF Calfiornia [sic]

Max Fecht, Norman Cooper et al

v.

The Price Compnay [sic], RObert [sic] Price, Dennis Zook, and Ted Wallace

JUDGMENT IN A CIVIL CASE

CASE NUMBER 92-0497-B (BTM)

(Filed Mar. 22, 1993)

[ ] **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

[X] **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that defendants' motion to dismiss the Second Amended Complaint is granted without leave to amend under Federal Rules of Civil Procedure 12(b)(6) and 9(b). This action is dismissed on the merits with prejudice. Defendants shall recover their costs of action ----------

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March 22, 1993
Date

Don Hendrix
Clerk

/s/ M.C. Stottlemyer
M. C. Stottlemyer
(By) Deputy Clerk

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MAX FECHT, On behalf of himself and all other similarly situated; ERROL MARCUS; NORMAN COOPER; HAMILTON J. SAH, et al., Plaintiffs-Appellants, v. THE PRICE COMPANY; ROBERT W. PRICE; DENNIS R. ZOOK; THEODORE WALLACE, et al., Defendants-Appellees.	No. 93-55541 D.C. No. CV-92-00497-RMB **ORDER** (Filed Oct. 20, 1994)

Before: D.W. NELSON, NORRIS, and BOGGS,* Circuit Judges

Submission of this case is withdrawn until final disposition of *In re Glenfed, Inc. Sec. Litig.*, No. 92-55419, now pending before this court.

IT IS SO ORDERED.

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* Honorable Danny J. Boggs, United States Court of Appeals for the Sixth Circuit, sitting by designation.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MAX FECHT, On behalf of himself and all other similarly situated; ERROL MARCUS; NORMAN COOPER; HAMILTON J. SAH, et al., Plaintiffs-Appellants, v. THE PRICE COMPANY; ROBERT W. PRICE; DENNIS R. ZOOK; THEODORE WALLACE, et al., Defendants-Appellees.	No. 93-55541 D.C. No. CV-92-00497-RMB **ORDER** (Filed Jan. 4, 1995)

Before: D.W. NELSON, NORRIS, and BOGGS,* Circuit Judges

This matter is ORDERED resubmitted effective January 3, 1995.

* Honorable Danny J. Boggs, United States Court of Appeals for the Sixth Circuit, sitting by designation.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MAX FECHT, On behalf of himself and all other similarly situated; ERROL MARCUS; NORMAN COOPER; HAMILTON J. SAH, et al., Plaintiffs-Appellants, v. THE PRICE COMPANY; ROBERT W. PRICE; DENNIS R. ZOOK; THEODORE WALLACE, et al., Defendants-Appellees.	No. 93-55541 D.C. No. CV-92-00497-RMB **ORDER** (Filed Jun. 16, 1995)

Before: D.W. NELSON, NORRIS, and BOGGS,* Circuit Judges

The parties are hereby directed to file supplemental briefs addressing the application to this case of Part II of *In Re: GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1549-54 (9th Cir. 1994) (en banc). The briefs shall be no more than fifteen (15) pages and shall be filed within twenty-one (21) days of the date of this order.

IT IS SO ORDERED.

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* Honorable Danny J. Boggs, United States Court of Appeals for the Sixth Circuit, sitting by designation.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MAX FECHT, On behalf of himself and all other similarly situated; ERROL MARCUS; NORMAN COOPER; HAMILTON J. SAH, et al., Plaintiffs-Appellants, v. THE PRICE COMPANY; ROBERT W. PRICE; DENNIS R. ZOOK; THEODORE WALLACE, et al., Defendants-Appellees.	No. 93-55541 D.C. No. CV-92-00497-RMB **ORDER** (Filed Jan. 8, 1996)

Before: D.W. NELSON, NORRIS, and BOGGS,* Circuit Judges

The panel, as constituted above, has voted unanimously to deny the petition for rehearing and has unanimously recommended rejection of the suggestion for a rehearing en banc.

The full court has been advised of the suggestion for en banc rehearing and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

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* Honorable Danny J. Boggs, United States Court of Appeals for the Sixth Circuit, sitting by designation.

The petition for rehearing is **DENIED**, and the suggestion for a rehearing en banc is **REJECTED**.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MAX FECHT, On behalf of himself and all other similarly situated; ERROL MARCUS; NORMAN COOPER; HAMILTON J. SAH, et al., Plaintiffs-Appellants, v. THE PRICE COMPANY; ROBERT W. PRICE; DENNIS R. ZOOK; THEODORE WALLACE, et al., Defendants-Appellees.	No. 93-55541 D.C. No. CV-92-00497-RMB **ORDER** (Filed Jan. 18, 1996)

Before: NORRIS, Circuit Judge

Upon due consideration of appellees's [sic] motion for stay of mandate pending the filing of a petition for writ of certiorari, such petition to be filed within 30 days of this order,

IT IS ORDERED that the motion for stay of mandate be **GRANTED.***

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* In the event that the petition for writ of certiorari is timely filed, "the stay shall continue until final disposition by the Supreme Court." Fed. R. App. P. 41(b).

FEDERAL
SECURITIES LAW
Reports

-EXTRA EDITION-

NUMBER **1696** JANUARY 10, 1996

PRIVATE SECURITIES LITIGATION

Reform Act of 1995

Law & Explanation

James Hamilton, J.D., LL.M

Private Securities Litigation Reform – Sec. 101

LAW TEXT

One Hundred Fourth Congress of the United States of America

AT THE FIRST SESSION

Begun and held at the City of Washington on Wednesday, the fourth day of January, one thousand nine hundred and ninety-five

An Act

To reform Federal securities litigation, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

[¶ 201]

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) Short Title. – This Act may be cited as the "Private Securities Litigation Reform Act of 1995".

(b) Table of Contents. – The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

TITLE I – REDUCTION OF ABUSIVE LITIGATION

Sec. 101. Private securities litigation reform.

Sec. 102. Safe harbor for forward-looking statements.

Sec. 103. Elimination of certain abusive practices.

Sec. 104. Authority of Commission to prosecute aiding and abetting.

Sec. 105. Loss causation.

Sec. 106. Study and report on protections for senior citizens and qualified retirement plans.

Sec. 107. Amendment to Racketeer Influenced and Corrupt Organizations Act.

Sec. 108. Applicability.

TITLE II – REDUCTION OF COERCIVE SETTLEMENTS

Sec. 201. Proportionate liability.

Sec. 202. Applicability.

Sec. 203. Rule of construction.

TITLE III – AUDITOR DISCLOSURE OF CORPORATE FRAUD

Sec. 301. Fraud detection and disclosure.

TITLE I – REDUCTION OF ABUSIVE LITIGATION

[¶ 202]

SEC. 101. PRIVATE SECURITIES LITIGATION REFORM.

(a) Securities Act of 1933. – Title I of the Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by adding at the end the following new section:

"SEC. 27. PRIVATE SECURITIES LITIGATION.

"(a) Private Class Actions. –

"(1) In general. – The provisions of this subsection shall apply to each private action arising under this title that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.

"(2) Certification filed with complaint. –

"(A) In general. – Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that –

"(i) states that the plaintiff has reviewed the complaint and authorized its filing;

"(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction of plaintiff's counsel or in order to participate in any private action arising under this title;

"(iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;

"(iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;

"(v) identifies any other action under this title, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve, or served, as a representative party on behalf of a class; and

"(vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

"(B) Nonwaiver of attorney-client privilege. – The certification filed pursuant to subparagraph (A) shall not be construed to be a waiver of the attorney-client privilege.

"(3) Appointment of lead plaintiff. –

"(A) Early notice to class members. –

"(i) In general. – Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class –

"(I) of the pendency of the action, the claims asserted therein, and the purported class period; and

"(II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

"(ii) Multiple actions. – If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title is filed, only the plaintiff or plaintiffs in the first filed action shall be required to cause notice to be published in accordance with clause (i).

"(iii) Additional notices may be required under federal rules. – Notice required under clause (i) shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure.

"(B) Appointment of lead plaintiff. –

"(i) In general. – Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the 'most adequate plaintiff') in accordance with this subparagraph.

"(ii) Consolidated actions. – If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title has been filed, and any party has sought to consolidate those actions for pretrial purposes or for trial, the court shall not make the determination required by clause (i) until after the decision on the motion to consolidate is rendered. As soon as practicable after such decision is rendered, the court shall appoint the most adequate plaintiff as lead plaintiff for the consolidated actions in accordance with this subparagraph.

"(iii) Rebuttable presumption. –

"(I) In general. – Subject to subclause (II), for purposes of clause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this title is the person or group of persons that –

"(aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);

"(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

"(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

"(II) Rebuttal evidence. – The presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff –

"(aa) will not fairly and adequately protect the interests of the class; or

"(bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

"(iv) Discovery. – For purposes of this subparagraph, discovery relating to whether a member or members of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class.

"(v) Selection of lead counsel. – The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

"(vi) Restrictions on professional plaintiffs. – Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

"(4) Recovery by plaintiffs. – The share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of the class.

"(5) Restrictions on settlements under seal. – The terms and provisions of any settlement agreement of a class action shall not be filed under seal, except that on motion of any party to the settlement, the court may order filing under seal for those portions of a settlement agreement as to which good cause is shown for such filing under seal. For purposes of this paragraph, good cause shall exist only if publication of a term or provision of a settlement agreement would cause direct and substantial harm to any party.

"(6) Restrictions on payment of attorneys' fees and expenses. – Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.

"(7) Disclosure of settlement terms to class members. – Any proposed or final settlement agreement that is published or otherwise disseminated to the class shall include each of the following statements, along with a cover page summarizing the information contained in such statements:

"(A) Statement of plaintiff recovery. – The amount of the settlement proposed to be distributed to the parties to the action, determined in the aggregate and on an average per share basis.

"(B) Statement of potential outcome of case. –

"(i) Agreement on amount of damages. – If the settling parties agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement concerning the average amount of such potential damages per share.

"(ii) Disagreement on amount of damages. – If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement from each settling party concerning the issue or issues on which the parties disagree.

"(iii) Inadmissibility for certain purposes. – A statement made in accordance with clause (i) or (ii) concerning the amount of damages shall not be admissible in any Federal or State judicial action or administrative proceeding, other than an action or proceeding arising out of such statement.

"(C) Statement of attorneys' fees or costs sought. – If any of the settling parties or their counsel intend to apply to the court for an award of attorneys' fees or costs from any fund established as part of the settlement, a statement indicating which parties or counsel intend to make such an application, the amount of fees and costs that will be sought (including the amount of such fees and costs determined on an average per share basis), and a brief explanation supporting the fees and costs sought.

"(D) Identification of lawyers' representatives. – The name, telephone number, and address of one or more representatives of counsel for the plaintiff class who will be reasonably available to answer questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

"(E) Reasons for settlement. – A brief statement explaining the reasons why the parties are proposing the settlement.

"(F) Other information. – Such other information as may be required by the court.

"(8) Attorney conflict of interest. – If a plaintiff class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities that are the subject of the litigation, the court shall make a determination of whether such ownership or other interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class.

"(b) Stay of Discovery; Preservation of Evidence. –

"(1) In general. – In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

"(2) Preservation of evidence. – During the pendency of any stay of discovery pursuant to this subsection, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

"(3) Sanction for willful violation. – A party aggrieved by the willful failure of an opposing party to comply with paragraph (2) may apply to the court for an order awarding appropriate sanctions.

"(c) Sanctions for Abusive Litigation. –

"(1) Mandatory review by court. – In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

"(2) Mandatory sanctions. – If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the

Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

"(3) Presumption in favor of attorneys' fees and costs. –

"(A) In general. – Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction –

"(i) for failure of any responsive pleading or dispositve motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

"(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

"(B) Rebuttal evidence. – The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that –

"(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an

award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

"(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

"(C) Sanctions. – If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

"(d) Defendant's Right to Written Interrogatories. – In any private action arising under this title in which the plaintiff may recover money damages only on proof that a defendant acted with a particular state of mind, the court shall, when requested by a defendant, submit to the jury a written interrogatory on the issue of each such defendant's state of mind at the time the alleged violation occurred.".

(b) Securities Exchange Act of 1934. – Title I of the Securities Exchange Act of 1934 (78a et seq.) is amended by inserting after section 21C the following new section:

"SEC. 21D. PRIVATE SECURITIES LITIGATION.

"(a) Private Class Actions. –

"(1) In general. – The provisions of this subsection shall apply in each private action arising under this title that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.

"(2) Certification filed with complaint. –

"(A) In general. – Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that –

"(i) states that the plaintiff has reviewed the complaint and authorized its filing;

"(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction of plaintiff's counsel or in order to participate in any private action arising under this title;

"(iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;

"(iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;

"(v) identifies any other action under this title, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve as a representative party on behalf of a class; and

"(vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

"(B) Nonwaiver of attorney-client privilege. – The certification filed pursuant to subparagraph (A) shall not be construed to be a waiver of the attorney-client privilege.

"(3) Appointment of lead plaintiff. –

"(A) Early notice to class members. –

"(i) In general. – Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class –

"(I) of the pendency of the action, the claims asserted therein, and the purported class period; and

"(II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

"(ii) Multiple actions. – If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title is filed, only the plaintiff or plaintiffs in the first filed action shall be required to cause notice to be published in accordance with clause (i).

"(iii) Additional notices may be required under federal rules. – Notice required under clause (i) shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure.

"(B) Appointment of lead plaintiff. –

"(i) In general. – Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the 'most adequate plaintiff') in accordance with this subparagraph.

"(ii) Consolidated actions. – If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title has been filed, and any party has sought to consolidate those actions for pretrial purposes or for trial, the court shall not make the determination required by clause (i) until after the decision on the motion to consolidate is rendered. As soon as practicable after such decision is rendered, the court shall appoint the most adequate plaintiff as lead plaintiff for the consolidated actions in accordance with this paragraph.

"(iii) Rebuttable presumption. –

"(1) In general. – Subject to subclause (II), for purposes of clause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this title is the person or group of persons that –

"(aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);

"(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

"(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

"(II) Rebuttal evidence. – The presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff –

"(aa) will not fairly and adequately protect the interests of the class; or

"(bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

"(iv) Discovery. – For purposes of this subparagraph, discovery relating to whether a member or members of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class.

"(v) Selection of lead counsel. – The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

"(vi) Restrictions on professional plaintiffs. – Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

"(4) Recovery by plaintiffs. – The share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of a class.

"(5) Restrictions on settlements under seal. – The terms and provisions of any settlement agreement of a class action shall not be filed under seal, except that on motion of any party to the settlement, the court may order filing under seal for those portions of a settlement agreement as to which good cause is shown for such filing under seal. For purposes of this paragraph, good cause shall exist only if publication of a term or provision of a settlement agreement would cause direct and substantial harm to any party.

"(6) Restrictions on payment of attorneys' fees and expenses. – Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.

"(7) Disclosure of settlement terms to class members. – Any proposed or final settlement agreement that is published or otherwise disseminated to the class shall include each of the following statements, along with a cover page summarizing the information contained in such statements:

"(A) Statement of plaintiff recovery. – The amount of the settlement proposed to be distributed to the parties to the action, determined in the aggregate and on an average per share basis.

"(B) Statement of potential outcome of case. –

"(i) Agreement on amount of damages. – If the settling parties agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement concerning the average amount of such potential damages per share.

"(ii) Disagreement on amount of damages. – If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement from each settling party concerning the issue or issues on which the parties disagree.

"(iii) Inadmissibility for certain purposes. – A statement made in accordance with clause (i) or (ii) concerning the amount of damages shall not be admissible in any Federal or State judicial action or administrative proceeding, other than an action or proceeding arising out of such statement.

"(C) Statement of attorneys' fees or costs sought. – If any of the settling parties or their counsel intend to apply to the court for an award of attorneys' fees or costs from any fund established as part of the settlement, a statement indicating which parties or counsel intend to make such an application, the amount of fees and costs that will be sought (including the amount of such fees and costs determined on an average per share basis), and a brief explanation supporting the fees and costs sought. Such information shall be clearly summarized on the cover page of any notice to a party of any proposed or final settlement agreement.

"(D) Identification of lawyers' representatives. – The name, telephone number, and address of one or more representatives of counsel for the plaintiff class who will be reasonably available to answer questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

"(E) Reasons for settlement. – A brief statement explaining the reasons why the parties are proposing the settlement.

"(F) Other information. – Such other information as may be required by the court.

"(8) Security for payment of costs in class actions. – In any private action arising under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, the court may require an undertaking from the attorneys for the plaintiff class, the plaintiff class, or both, or from the attorneys for the defendant, the defendant, or both, in such proportions and at such times as the court determines are just and equitable, for the payment of

fees and expenses that may be awarded under this subsection.

"(9) Attorney conflict of interest. – If a plaintiff class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities that are the subject of the litigation, the court shall make a determination of whether such ownership or other interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class.

"(b) Requirements for Securities Fraud Actions. –

"(1) Misleading statements and omissions. – In any private action arising under this title in which the plaintiff alleges that the defendant –

'(A) made an untrue statement of a material fact; or

'(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

"(2) Required state of mind. – In any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this title, state with particularity

facts giving rise to a strong inference that the defendant acted with the required state of mind.

"(3) Motion to dismiss; stay of discovery. –

"(A) Dismissal for failure to meet pleading requirements. – In any private action arising under this title, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

"(B) Stay of discovery. – In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

"(C) Preservation of evidence. –

"(i) In general. – During the pendency of any stay of discovery pursuant to this paragraph, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

"(ii) Sanction for willful violation. – A party aggrieved by the willful failure of an opposing party to comply with clause (i)

may apply to the court for an order awarding appropriate sanctions.

"(4) Loss causation. – In any private action arising under this title, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages.

"(c) Sanctions for Abusive Litigation. –

"(1) Mandatory review by court. – In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

"(2) Mandatory sanctions. – If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

"(3) Presumption in favor of attorneys' fees and costs. –

"(A) In general. – Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction –

"(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

"(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

"(B) Rebuttal evidence. – The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that –

"(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

"(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

"(C) Sanctions. – If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

"(d) Defendant's Right to Written Interrogatories. – In any private action arising under this title in

which the plaintiff may recover money damages, the court shall, when requested by a defendant, submit to the jury a written interrogatory on the issue of each such defendant's state of mind at the time the alleged violation occurred.

"(e) Limitation on Damages. –

"(1) In general. – Except as provided in paragraph (2), in any private action arising under this tile in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

"(2) Exception. – In any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

"(3) Definition. – For purposes of this subsection, the 'mean trading price' of a security

shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period referred to in paragraph (1).".

[¶ 203]

SEC. 102. SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

(a) Amendment to the Securities Act of 1933. – Title I of the Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by inserting after section 27 (as added by this Act) the following new section:

"SEC. 27A. APPLICATION OF SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

"(a) Applicability. – This section shall apply only to a forward-looking statement made by –

"(1) an issuer that, at the time that the statement is made, is subject to the reporting requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934;

"(2) a person acting on behalf of such issuer;

"(3) an outside reviewer retained by such issuer making a statement on behalf of such issuer; or

"(4) an underwriter, with respect to information provided by such issuer or information derived from information provided by the issuer.

"(b) Exclusions. – Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, this section shall not apply to a forward-looking statement –

"(1) that is made with respect to the business or operations of the issuer, if the issuer –

"(A) during the 3-year period preceding the date on which the statement was first made –

"(i) was convicted of any felony or misdemeanor described in clauses (i) through (iv) of section 15(b)(4)(B) of the Securities Exchange Act of 1934; or

"(ii) has been made the subject of a judicial or administrative decree or order arising out of a governmental action that –

"(I) prohibits future violations of the antifraud provisions of the securities laws;

"(II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or

"(III) determines that the issuer violated the antifraud provisions of the securities laws;

"(B) makes the forward-looking statement in connection with an offering of securities by a blank check company;

"(C) issues penny stock;

"(D) makes the forward-looking statement in connection with a rollup transaction; or

"(E) makes the forward-looking statement in connection with a going private transaction; or

"(2) that is –

"(A) included in a financial statement prepared in accordance with generally accepted accounting principles;

"(B) contained in a registration statement of, or otherwise issued by, an investment company;

"(C) made in connection with a tender offer;

"(D) made in connection with an initial public offering;

"(E) made in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program; or

"(F) made in a disclosure of beneficial ownership in a report required to be filed with the Commission pursuant to section 13(d) of the Securities Exchange Act of 1934.

"(c) Safe Harbor. –

"(1) In general. – Except as provided in subsection (b), in any private action arising under this title that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that –

"(A) the forward-looking statement is –

"(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

"(ii) immaterial; or

"(B) the plaintiff fails to prove that the forward-looking statement –

"(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

"(ii) if made by a business entity; was –

"(I) made by or with the approval of an executive officer of that entity, and

"(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

"(2) Oral forward-looking statements. – In the case of an oral forward-looking statement made by an issuer that is subject to the reporting requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934, or by a person acting on behalf of such issuer, the requirement set forth in paragraph (1)(A) shall be deemed to be satisfied –

"(A) if the oral forward-looking statement is accompanied by a cautionary statement –

"(i) that the particular oral statement is a forward-looking statement; and

"(ii) that the actual results could differ materially from those projected in the forward-looking statement; and

"(B) if –

"(i) the oral forward-looking statement is accompanied by an oral statement that additional information concerning factors that could cause actual results to differ materially from those in the forward-looking

statement is contained in a readily available written document, or portion thereof;

"(ii) the accompanying oral statement referred to in clause (i) identifies the document, or portion thereof, that contains the additional information about those factors relating to the forward-looking statement; and

"(iii) the information contained in that written document is a cautionary statement that satisfies the standard established in paragraph (1)(A).

"(3) Availability. – Any document filed with the Commission or generally disseminated shall be deemed to be readily available for purposes of paragraph (2).

"(4) Effect on other safe harbors. – The exemption provided for in paragraph (1) shall be in addition to any exemption that the Commission may establish by rule or regulation under subsection (g).

"(d) Duty To Update. – Nothing in this section shall impose upon any person a duty to update a forward-looking statement.

"(e) Dispositive Motion. – On any motion to dismiss based upon subsection (c)(1), the court shall consider any statement cited in the complaint and cautionary statement accompanying the forward-looking statement, which are not subject to material dispute, cited by the defendant.

"(f) Stay Pending Decision on Motion. – In any private action arising under this title, the court shall stay discovery (other than discovery that is specifically directed to the applicability of the exemption provided for in this section) during the pendency of any motion by

a defendant for summary judgment that is based on the grounds that –

"(1) the statement or omission upon which the complaint is based is a forward-looking statement within the meaning of this section; and

"(2) the exemption provided for in this section precludes a claim for relief.

"(g) Exemption Authority. – In addition to the exemptions provided for in this section, the Commission may, by rule or regulation, provide exemptions from or under any provision of this title, including with respect to liability that is based on a statement or that is based on projections or other forward-looking information, if and to the extent that any such exemption is consistent with the public interest and the protection of investors, as determined by the Commission.

"(h) Effect on Other Authority of Commission. – Nothing in this section limits, either expressly or by implication, the authority of the Commission to exercise similar authority or to adopt similar rules and regulations with respect to forward-looking statements under any other statute under which the Commission exercises rulemaking authority.

"(i) Definitions. – For purposes of this section, the following definitions shall apply:

"(1) Forward-looking statement. – The term 'forward-looking statement' means –

"(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

"(B) a statement of the plans and objectives of management for future operations, including

plans or objectives relating to the products or services of the issuer;

"(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

"(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

"(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

"(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

"(2) Investment company. – The term 'investment company' has the same meaning as in section 3(a) of the Investment Company Act of 1940.

"(3) Penny stock. – The term 'penny stock' has the same meaning as in section 3(a)(51) of the Securities Exchange Act of 1934, and the rules and regulations, or orders issued pursuant to that section.

"(4) Going private transaction. – The term 'going private transaction' has the meaning given that term under the rules or regulations of the Commission issued pursuant to section 13(e) of the Securities Exchange Act of 1934.

"(5) Securities laws. – The term 'securities laws' has the same meaning as in section 3 of the Securities Exchange Act of 1934.

"(6) Person acting on behalf of an issuer. – The term 'person acting on behalf of an issuer' means an officer, director, or employee of the issuer.

"(7) Other terms. – The terms 'blank check company', 'rollup transaction', 'partnership', 'limited liability company', 'executive officer of an entity' and 'direct participation investment program', have the meanings given those terms by rule or regulation of the Commission.".

(b) Amendment to the Securities Exchange Act of 1934. – The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 21D (as added by this Act) the following new section:

"SEC. 21E. APPLICATION OF SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

"(a) Applicability. – This section shall apply only to a forward-looking statement made by –

"(1) an issuer that, at the time that the statement is made, is subject to the reporting requirements of section 13(a) or section 15(d);

"(2) a person acting on behalf of such issuer;

"(3) an outside reviewer retained by such issuer making a statement on behalf of such issuer; or

"(4) an underwriter, with respect to information provided by such issuer or information derived from information provided by such issuer.

"(b) Exclusions. – Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, this section shall not apply to a forward-looking statement –

"(1) that is made with respect to the business or operations of the issuer, if the issuer –

"(A) during the 3-year period preceding the date on which the statement was first made –

"(i) was convicted of any felony or misdemeanor described in clauses (i) through (iv) of section 15(b)(4)(B); or

"(ii) has been made the subject of a judicial or administrative decree or order arising out of a governmental action that –

"(I) prohibits future violations of the antifraud provisions of the securities laws;

"(II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or

"(III) determines that the issuer violated the antifraud provisions of the securities laws;

"(B) makes the forward-looking statement in connection with an offering of securities by a blank check company;

"(C) issues penny stock;

"(D) makes the forward-looking statement in connection with a rollup transaction; or

"(E) makes the forward-looking statement in connection with a going private transaction; or

"(2) that is –

"(A) included in a financial statement prepared in accordance with generally accepted accounting principles;

"(B) contained in a registration statement of, or otherwise issued by, an investment company;

"(C) made in connection with a tender offer;

"(D) made in connection with an initial public offering;

"(E) made in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program; or

"(F) made in a disclosure of beneficial ownership in a report required to be filed with the Commission pursuant to section 13(d).

"(c) Safe Harbor. –

"(1) In general. – Except as provided in subsection (b), in any private action arising under this title that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that –

"(A) the forward-looking statement is –

"(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

"(ii) immaterial; or

"(B) the plaintiff fails to prove that the forward-looking statement –

"(i) if made by a natural person, was made with actual knowledge by that person

that the statement was false or misleading; or

"(ii) if made by a business entity; was –

"(I) made by or with the approval of an executive officer of that entity; and

"(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

"(2) Oral forward-looking statements. – In the case of an oral forward-looking statement made by an issuer that is subject to the reporting requirements of section 13(a) or section 15(d), or by a person acting on behalf of such issuer, the requirement set forth in paragraph (1)(A) shall be deemed to be satisfied –

"(A) if the oral forward-looking statement is accompanied by a cautionary statement –

"(i) that the particular oral statement is a forward-looking statement; and

"(ii) that the actual results might differ materially from those projected in the forward-looking statement; and

"(B) if –

"(i) the oral forward-looking statement is accompanied by an oral statement that additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statement is contained in a readily available written document, or portion thereof;

"(ii) the accompanying oral statement referred to in clause (i) identifies the document, or portion thereof, that contains the

additional information about those factors relating to the forward-looking statement; and

"(iii) the information contained in that written document is a cautionary statement that satisfies the standard established in paragraph (1)(A).

"(3) Availability. – Any document filed with the Commission or generally disseminated shall be deemed to be readily available for purposes of paragraph (2).

"(4) Effect on other safe harbors. – The exemption provided for in paragraph (1) shall be in addition to any exemption that the Commission may establish by rule or regulation under subsection (g).

"(d) Duty To Update. – Nothing in this section shall impose upon any person a duty to update a forward-looking statement.

"(e) Dispositive Motion. – On any motion to dismiss based upon subsection (c)(1), the court shall consider any statement cited in the complaint and any cautionary statement accompanying the forward-looking statement, which are not subject to material dispute, cited by the defendant.

"(f) Stay Pending Decision on Motion. – In any private action arising under this title, the court shall stay discovery (other than discovery that is specifically directed to the applicability of the exemption provided for in this section) during the pendency of any motion by a defendant for summary judgment that is based on the grounds that –

"(1) the statement or omission upon which the complaint is based is a forward-looking statement within the meaning of this section; and

"(2) the exemption provided for in this section precludes a claim for relief.

"(g) Exemption Authority. – In addition to the exemptions provided for in this section, the Commission may, by rule or regulation, provide exemptions from or under any provision of this title, including with respect to liability that is based on a statement or that is based on projections or other forward-looking information, if and to the extent that any such exemption is consistent with the public interest and the protection of investors, as determined by the Commission.

"(h) Effect on Other Authority of Commission. – Nothing in this section limits, either expressly or by implication, the authority of the Commission to exercise similar authority or to adopt similar rules and regulations with respect to forward-looking statements under any other statute under which the Commission exercises rulemaking authority.

"(i) Definitions. – For purposes of this section, the following definitions shall apply:

"(1) Forward-looking statement. – The term 'forward-looking statement' means –

"(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

"(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;

"(C) a statement of future economic performance, including any such statement contained

in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

"(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

"(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

"(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

"(2) Investment company. – The term 'investment company' has the same meaning as in section 3(a) of the Investment Company Act of 1940.

"(3) Going private transaction. – The term 'going private transaction' has the meaning given that term under the rules or regulations of the Commission issued pursuant to section 13(e).

"(4) Person acting on behalf of an issuer. – The term 'person acting on behalf of an issuer' means any officer, director, or employee of such issuer.

"(5) Other terms. – The terms 'blank check company', 'rollup transaction', 'partnership', 'limited liability company', 'executive officer of an entity' and 'direct participation investment program', have the meanings given those terms by rule or regulation of the Commission.".

[¶ 204]

SEC. 103. ELIMINATION OF CERTAIN ABUSIVE PRACTICES.

(a) Prohibition of Referral Fees. – Section 15(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)) is amended by adding at the end the following new paragraph:

"(8) Prohibition of referral fees. – No broker or dealer, or person associated with a broker or dealer, may solicit or accept, directly or indirectly, remuneration for assisting an attorney in obtaining the representation of any person in any private action arising under this title or under the Securities Act of 1933.".

(b) Prohibition of Attorneys' Fees Paid From Commission Disgorgement Funds. –

(1) Securities act of 1933. – Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following new subsection:

"(f) Prohibition of Attorneys' Fees Paid From Commission Disgorgement Funds. – Except as otherwise ordered by the court upon motion by the Commission, or, in the case of an administrative action, as otherwise ordered by the Commission, funds disgorged as the result of an action brought by the Commission in Federal court, or as a result of any Commission administrative action, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.".

(2) Securities exchange act of 1934. – Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended by adding at the end the following new paragraph:

"(4) Prohibition of attorneys' fees paid from commission disgorgement funds. – Except as otherwise ordered by the court upon motion by the Commission, or, in the case of an administrative action, as otherwise ordered by the Commission, funds disgorged as the result of an action brought by the Commission in Federal court, or as a result of any Commission administrative action, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.".

[¶ 205]

SEC. 104. AUTHORITY OF COMMISSION TO PROSECUTE AIDING AND ABETTING.

Section 20 of the Securities Exchange Act of 1934 (15 U.S.C. 78t) is amended –

(1) by striking the section heading and inserting the following:

"liability of controlling persons and persons who aid and abet violations"; and

(2) by adding at the end the following new subsection:

"(f) Prosecution of Persons Who Aid and Abet Violations. – For purposes of any action brought by the Commission under paragraph (1) or (3) of section 21(d), any person that knowingly provides substantial assistance to another person in violation of a provision of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.".

[¶ 206]

SEC. 105. LOSS CAUSATION.

Section 12 of the Securities Act of 1933 (15 U.S.C. 77l) is amended –

(1) by inserting "(a) In General. –" before "Any person";

(2) by inserting ", subject to subsection (b)," after "shall be liable"; and

(3) by adding at the end the following:

"(b) Loss Causation. – In an action described in subsection (a)(2), if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.".

[¶ 207]

SEC. 106. STUDY AND REPORT ON PROTECTIONS FOR SENIOR CITIZENS AND QUALIFIED RETIREMENT PLANS.

(a) In General. – Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall –

(1) determine whether investors that are senior citizens or qualified retirement plans require greater protection against securities fraud than is provided in this Act and the amendments made by this Act;

(2) determine whether investors that are senior citizens or qualified retirement plans have been adversely impacted by abusive or unnecessary securities fraud litigation, and whether the provisions in this Act or amendments made by this Act are sufficient to protect their investments from such litigation; and

(3) if so, submit to the Congress a report containing recommendations on protections from securities fraud and abusive or unnecessary securities fraud litigation that the Commission determines to be appropriate to thoroughly protect such investors.

(b) Definitions. – For purposes of this section –

(1) the term "qualified retirement plan" has the same meaning as in section 4974(c) of the Internal Revenue Code of 1986; and

(2) the term "senior citizen" means an individual who is 62 years of age or older as of the date of the securities transaction at issue.

Public Law 104-67

[¶ 208]

SEC. 107. AMENDMENT TO RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT.

Section 1964(c) of title 18, United States Code, is amended by inserting before the period ", except that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962. The exception contained in the preceding sentence does not apply to an action against any person that is criminally convicted in connection with the fraud, in which case the statute of

limitations shall start to run on the date on which the conviction becomes final".

[¶ 209]

SEC. 108. APPLICABILITY.

The amendments made by this title shall not affect or apply to any private action arising under title I of the Securities Exchange Act of 1934 or title I of the Securities Act of 1933, commenced before and pending on the date of enactment of this Act.

TITLE II – REDUCTION OF COERCIVE SETTLEMENTS

[¶ 210]

SEC. 201. PROPORTIONATE LIABILITY.

(a) Amendment to Securities and Exchange Act of 1934. – Section 21D of the Securities Exchange Act of 1934 (as added by this Act) is amended by adding at the end the following new subsection:

"(g) Proportionate Liability. –

"(1) Applicability. – Nothing in this subsection shall be construed to create, affect, or in any manner modify, the standard for liability associated with any action arising under the securities laws.

"(2) Liability for damages. –

"(A) Joint and several liability. – Any covered person against whom a final judgment is entered in a private action shall be liable for damages jointly and severally only if the trier of fact specifically determines that such covered

person knowingly committed a violation of the securities laws.

"(B) Proportionate liability. –

"(i) In general. – Except as provided in paragraph (1), a covered person against whom a final judgment is entered in a private action shall be liable solely for the portion of the judgment that corresponds to the percentage of responsibility of that covered person, as determined under paragraph (3).

"(ii) Recovery by and costs of covered person. – In any case in which a contractual relationship permits, a covered person that prevails in any private action may recover the attorney's fees and costs of that covered person in connection with the action.

"(3) Determination of responsibility. –

"(A) In general. – In any private action, the court shall instruct the jury to answer special interrogatories, or if there is no jury, shall make findings, with respect to each covered person and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff, including persons who have entered into settlements with the plaintiff or plaintiffs, concerning –

"(i) whether such person violated the securities laws;

"(ii) the percentage of responsibility of such person, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff; and

"(iii) whether such person knowingly committed a violation of the securities laws.

"(B) Contents of special interrogatories or findings. – The responses to interrogatories, or findings, as appropriate, under subparagraph (A) shall specify the total amount of damages that the plaintiff is entitled to recover and the percentage of responsibility of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs.

"(C) Factors for consideration. – In determining the percentage of responsibility under this paragraph, the trier of fact shall consider –

"(i) the nature of the conduct of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs; and

"(ii) the nature and extent of the causal relationship between the conduct of each such person and the damages incurred by the plaintiff or plaintiffs.

"(4) Uncollectible share. –

"(A) In general. – Notwithstanding paragraph (2)(B), upon motion made not later than 6 months after a final judgment is entered in any private action, the court determines that all or part of the share of the judgment of the covered person is not collectible against that covered person, and is also not collectible against a covered person described in paragraph (2)(A), each covered person described in paragraph (2)(B) shall be liable for the uncollectible share as follows:

"(i) Percentage of net worth. – Each covered person shall be jointly and severally

liable for the uncollectible share if the plaintiff establishes that –

"(I) the plaintiff is an individual whose recoverable damages under the final judgment are equal to more than 10 percent of the net worth of the plaintiff; and

"(II) the net worth of the plaintiff is equal to less than $200,000.

"(ii) Other plaintiffs. – With respect to any plaintiff not described in subclauses (I) and (II) of clause (i), each covered person shall be liable for the uncollectible share in proportion to the percentage of responsibility of that covered person, except that the total liability of a covered person under this clause may not exceed 50 percent of the proportionate share of that covered person, as determined under paragraph (3)(B).

"(iii) Net worth. – For purposes of this subparagraph, net worth shall be determined as of the date immediately preceding the date of the purchase or sale (as applicable) by the plaintiff of the security that is the subject of the action, and shall be equal to the fair market value of assets, minus liabilities, including the net value of the investments of the plaintiff in real and personal property (including personal residences).

"(B) Overall limit. – In no case shall the total payments required pursuant to subparagraph (A) exceed the amount of the uncollectible share.

"(C) Covered persons subject to contribution. – A covered person against whom judgment

is not collectible shall be subject to contribution and to any continuing liability to the plaintiff on the judgment.

"(5) Right of contribution. – To the extent that a covered person is required to make an additional payment pursuant to paragraph (4), that covered person may recover contribution –

"(A) from the covered person originally liable to make the payment;

"(B) from any covered person liable jointly and severally pursuant to paragraph (2)(A);

"(C) from any covered person held proportionately liable pursuant to this paragraph who is liable to make the same payment and has paid less than his or her proportionate share of that payment; or

"(D) from any other person responsible for the conduct giving rise to the payment that would have been liable to make the same payment.

"(6) Nondisclosure to jury. – The standard for allocation of damages under paragraphs (2) and (3) and the procedure for reallocation of uncollectible shares under paragraph (4) shall not be disclosed to members of the jury.

"(7) Settlement discharge. –

"(A) In general. – A covered person who settles any private action at any time before final verdict or judgment shall be discharged from all claims for contribution brought by other persons. Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the

settling covered person arising out of the action. The order shall bar all future claims for contribution arising out of the action –

"(i) by any person against the settling covered person; and

"(ii) by the settling covered person against any person, other than a person whose liability has been extinguished by the settlement of the settling covered person.

"(B) Reduction. – If a covered person enters into a settlement with the plaintiff prior to final verdict or judgment, the verdict or judgment shall be reduced by the greater of –

"(i) an amount that corresponds to the percentage of responsibility of that covered person; or

"(ii) the amount paid to the plaintiff by that covered person.

"(8) Contribution. – A covered person who becomes jointly and severally liable for damages in any private action may recover contribution from any other person who, if joined in the original action, would have been liable for the same damages. A claim for contribution shall be determined based on the percentage of responsibility of the claimant and of each person against whom a claim for contribution is made.

"(9) Statute of limitations for contribution. – In any private action determining liability, an action for contribution shall be brought not later than 6 months after the entry of a final, nonappealable judgment in the action, except that an action for contribution brought by a covered person who was required to make an additional payment pursuant to paragraph

(4) may be brought not later than 6 months after the date on which such payment was made.

"(10) Definitions. – For purposes of this subsection –

"(A) a covered person 'knowingly commits a violation of the securities laws' –

"(i) with respect to an action that is based on an untrue statement of material fact or omission of a material fact necessary to make the statement not misleading, if –

"(I) that covered person makes an untrue statement of a material fact, with actual knowledge that the representation is false, or omits to state a fact necessary in order to make the statement made not misleading, with actual knowledge that, as a result of the omission, one of the material representations of the covered person is false; and

"(II) persons are likely to reasonably rely on that misrepresentation or omission; and

"(ii) with respect to an action that is based on any conduct that is not described in clause (i), if that covered person engages in that conduct with actual knowledge of the facts and circumstances that make the conduct of that covered person a violation of the securities laws;

"(B) reckless conduct by a covered person shall not be construed to constitute a knowing commission of a violation of the securities laws by that covered person;

"(C) the term 'covered person' means –

"(i) a defendant in any private action arising under this title; or

"(ii) a defendant in any private action arising under section 11 of the Securities Act of 1933, who is an outside director of the issuer of the securities that are the subject of the action; and

"(D) the term 'outside director' shall have the meaning given such term by rule or regulation of the Commission.".

(b) Amendments to the Securities Act of 1933. – Section 11(f) of the Securities Act of 1933 (12 U.S.C. 77k(f)) is amended –

(1) by striking "All" and inserting "(1) Except as provided in paragraph (2), all"; and

(2) by adding at the end the following new paragraph:

"(2)(A) The liability of an outside director under subsection (e) shall be determined in accordance with section 38 of the Securities Exchange Act of 1934.

"(B) For purposes of this paragraph, the term 'outside director' shall have the meaning given such term by rule or regulation of the Commission.".

[¶ 211]

SEC. 202. APPLICABILITY.

The amendments made by this title shall not affect or apply to any private action arising under the securities

laws commenced before and pending on the date of enactment of this Act.

[¶ 212]

SEC. 203. RULE OF CONSTRUCTION.

Nothing in this Act or the amendments made by this Act shall be deemed to create or ratify any implied private right of action, or to prevent the Commission, by rule or regulation, from restricting or otherwise regulating private actions under the Securities Exchange Act of 1934.

TITLE III – AUDITOR DISCLOSURE OF CORPORATE FRAUD

[¶ 213]

SEC. 301. FRAUD DETECTION AND DISCLOSURE.

(a) In General. – The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting immediately after section 10 the following new section:

"SEC. 10A. AUDIT REQUIREMENTS.

"(a) In General. – Each audit required pursuant to this title of the financial statements of an issuer by an independent public accountant shall include, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission –

"(1) procedures designed to provide reasonable assurance of detecting illegal acts that would have a

direct and material effect on the determination of financial statement amounts;

"(2) procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein; and

"(3) an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year.

"(b) Required Response To Audit Discoveries. –

"(1) Investigation and report to management. – If, in the course of conducting an audit pursuant to this title to which subsection (a) applies, the independent public accountant detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the accountant shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission –

"(A)(i) determine whether it is likely that an illegal act has occurred; and

"(ii) if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and

"(B) as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors of the issuer in the absence of such a committee, is adequately informed with respect to illegal acts that have

been detected or have otherwise come to the attention of such accountant in the course of the audit, unless the illegal act is clearly inconsequential.

"(2) Response to failure to take remedial action. – If, after determining that the audit committee of the board of directors of the issuer, or the board of directors of the issuer in the absence of an audit committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of the accountant in the course of the audit of such accountant, the independent public accountant concludes that –

"(A) the illegal act has a material effect on the financial statements of the issuer;

"(B) the senior management has not taken, and the board of directors has not caused senior management to take, timely and appropriate remedial actions with respect to the illegal act; and

"(C) the failure to take remedial action is reasonably expected to warrant departure from a standard report of the auditor, when made, or warrant resignation from the audit engagement;

the independent public accountant shall, as soon as practicable, directly report its conclusions to the board of directors.

"(3) Notice to commission; response to failure to notify. – An issuer whose board of directors receives a report under paragraph (2) shall inform the Commission by notice not later than 1 business day after the receipt of such report and shall furnish the independent public accountant making such report with a copy of the notice furnished to the Commission. If the independent public accountant

fails to receive a copy of the notice before the expiration of the required 1-business-day period, the independent public accountant shall –

"(A) resign from the engagement; or

"(B) furnish to the Commission a copy of its report (or the documentation of any oral report given) not later than 1 business day following such failure to receive notice.

"(4) Report after resignation. – If an independent public accountant resigns from an engagement under paragraph (3)(A), the accountant shall, not later than 1 business day following the failure by the issuer to notify the Commission under paragraph (3), furnish to the Commission a copy of the accountant's report (or the documentation of any oral report given).

"(c) Auditor Liability Limitation. – No independent public accountant shall be liable in a private action for any finding, conclusion, or statement expressed in a report made pursuant to paragraph (3) or (4) of subsection (b), including any rule promulgated pursuant thereto.

"(d) Civil Penalties in Cease-and-Desist Proceedings. – If the Commission finds, after notice and opportunity for hearing in a proceeding instituted pursuant to section 21C, that an independent public accountant has willfully violated paragraph (3) or (4) of subsection (b), the Commission may, in addition to entering an order under section 21C, impose a civil penalty against the independent public accountant and any other person that the Commission finds was a cause of such violation. The determination to impose a civil penalty and the amount

of the penalty shall be governed by the standards set forth in section 21B.

"(e) Preservation of Existing Authority. – Except as provided in subsection (d), nothing in this section shall be held to limit or otherwise affect the authority of the Commission under this title.

"(f) Definition. – As used in this section, the term 'illegal act' means an act or omission that violates any law, or any rule or regulation having the force of law.".

(b) Effective Dates. – The amendment made by subsection (a) shall apply to each annual report –

(1) for any period beginning on or after January 1, 1996, with respect to any registrant that is required to file selected quarterly financial data pursuant to the rules or regulations of the Securities and Exchange Commission; and

(2) for any period beginning on or after January 1, 1997, with respect to any other registration.

Speaker of the House of Representatives.

Vice President of the United States and
President of the Senate.

OPPOSITION

BRIEF

Supreme Court, U.S.
FILED
MAR 15 1996
CLERK

No. 95-1347

In The

Supreme Court of the United States

October Term, 1995

THE PRICE COMPANY, ROBERT E. PRICE, DENNIS R. ZOOK AND THEODORE WALLACE,

Petitioners,

vs.

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO AND JOSEPH LASENSKY, On Behalf of Themselves and All Others Similarly Situated,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether this Court should grant certiorari to determine if plaintiffs, in a securities fraud action under § 10(b) of the Securities Exchange Act of 1934, may be required under Federal Rule of Civil Procedure 9(b) to plead facts raising an inference of scienter, when Congress has already resolved any conflict in the precedents by enacting the Private Securities Litigation Reform Act of 1995 and when decision of the issue cannot affect the outcome in this case.

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BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

I. STATEMENT OF THE CASE

Petitioners' statement of the case is biased, argumentative and incomplete in material respects. In particular, petitioners' statement omits the Complaint's allegations relating to defendants' motives for manipulating the price of Price Co. securities.

The Complaint alleges that the defendant Price Co. (the "Company"), and certain of its executive officers, misled investors and securities analysts regarding the Company's financial condition with false and misleading representations about the Company's retail-store expansion program, while concealing the fact that the expansion stores were unsuccessful and were losing money. Complaint ¶¶1-6, 19, 25-68. The Complaint alleges that they did so in order to artificially manipulate the price of Price Co. securities, enabling Price Co. to accomplish a $71 million offering of Real Estate Investment Trust ("REIT") securities, Complaint ¶¶36-42, and so that two executive officers could unload personal holdings of more than $1.6 million in common stock at fraudulently inflated prices. Complaint ¶¶13(b)-(c), 17, 68.

Petitioners' statement of the case studiously ignores the Complaint's allegations that petitioners manipulated the price of Price Co. securities in order to maximize proceeds from the offering of REIT securities, Complaint ¶¶36-42, and it utterly disregards the allegations of insider trading. Complaint ¶¶13(b)-(c), 17, 68. The Ninth Circuit held that these allegations provide "circumstantial evidence that the defendants *knew or had reason to know*

that the financial condition of the Company was deteriorating" when they made glowing statements about the Company's expansion program. Appendix ("App.") 13-14 (emphasis added).

The Ninth Circuit held that the Complaint stated a cause of action under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), with the particularity required by Federal Rule of Civil Procedure 9(b) – an unremarkable holding in light of the Complaint's allegations. *See* App. 1-14. As explained below, such allegations also raise an inference of scienter under Second Circuit law, so there is no possibility that purported differences between Ninth Circuit and Second Circuit law could have any impact on the outcome of this case. *See infra* at 6-10.

II. REASONS FOR DENYING THE WRIT

A. Introduction And Summary Of Argument

Petitioners ask this Court to determine whether "in the context of a securities fraud action" under § 10(b) of the Securities Exchange Act of 1934, plaintiffs shall be required to "plead facts sufficient to raise an inference that the defendants acted with fraudulent intent." Petition for a Writ of Certiorari ("Pet.") at i ("Question Presented"). They say there is a conflict between appellate decisions in the Second Circuit that have required plaintiffs in a securities fraud to plead facts raising a "strong inference" of fraudulent intent, and decisions like the Ninth Circuit's en banc opinion in *In re GlenFed Sec. Litig.*, 42 F.3d 1541 (9th Cir. 1994) (en banc), which have held that Federal Rule of Civil Procedure 9(b) does not require plaintiffs alleging securities fraud to plead facts raising

an inference of scienter. The petition should be denied because any theoretical conflict among these precedents was resolved by Congress in December of 1995, and because the Complaint in this case would pass muster even under the purportedly more stringent Second Circuit pleading standard that petitioners advocate.

Federal Rule of Civil Procedure 9(b) states that while "circumstances constituting fraud or mistake shall be stated with particularity," nonetheless, "[m]alice, intent, knowledge, and other condition of mind of a person may be averred generally." Fed. R. Civ. P. 9(b). "The clear weight of authority is that Rule 9 requires specification of the time, place, and content of an alleged false representation, *but not the circumstances or evidence from which fraudulent intent could be inferred.*"[1] Whatever the linguistic differences from Ninth Circuit opinions, decisions from the Second Circuit generally do not depart from this standard. *See, e.g., Brass v. American Film Technologies, Inc.*, 987 F.2d 142, 152-53 (2d Cir. 1993). Neither do decisions

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[1] *McGinty v. Beranger Volkswagen, Inc.*, 633 F.2d 226, 228-29 (1st Cir. 1980) (emphasis added); *accord, e.g., In re GlenFed Sec. Litig.*, 42 F.3d 1541, 1545-47 (9th Cir. 1994) (en banc); *Katz v. Household International, Inc.*, 36 F.3d 670, 674-76 (7th Cir. 1994); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991) ("a plaintiff need not specify the circumstances or evidence from which fraudulent intent could be inferred"); *Phelps v. Wichita Eagle-Beacon*, 886 F.2d 1262, 1270 n.5 (10th Cir. 1989); *IIT v. Cornfeld*, 619 F.2d 909, 923-24 (2d Cir. 1980); *Love v. Commercial Casualty Ins. Co.*, 26 F. Supp. 481, 481-82 (S.D. Miss. 1939).

from the First and Seventh Circuits.[2] Nonetheless, petitioners say that this Court should grant certiorari because a handful of decisions (mostly in the Second Circuit) appeared to depart from the Rule's text to demand that plaintiffs plead facts that raise an "inference of scienter" *in the limited context of securities fraud cases.*

To the extent that there was any conflict among the circuits on this question, it has been resolved by Congress which provided that, beginning on December 22, 1995, in private securities actions a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." Private Securities Litigation Reform Act, Public Law No. 104-67 ("PSLRA" or the "Act") § 108, *reprinted at* App. 160-61. Petitioners concede that Congress thus adopted a pleading standard that ensures "national uniformity as to applicable pleading standards in federal securities fraud actions commenced from December 22, 1995 forward." Pet. at 16.

This leaves no question worthy of this Court's attention. Although petitioners complain that Congress decided not to make the provision retroactive, providing instead that the new law " 'shall not affect or apply to any private action . . . commenced before and pending on the . . . date of enactment of this Act,' " Pet. at 11 (quoting App. 183), that was a choice for Congress and is not a ground for granting certiorari. *See infra* at 5-6.

Moreover, any remaining dispute over the applicable pleading standard can have little consequence on the facts of this case, for the Complaint's allegations raise a

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[2] *See Katz*, 36 F.3d at 675-76; *Romani*, 929 F.2d at 878; *McGinty*, 633 F.2d at 228-29.

strong inference of scienter under even the Second Circuit law that Petitioners argue should be followed. *See infra* at 6-10.

In sum, there is no reason for this Court to waste its time reviewing a question that has been considered and answered by the legislative branch and that cannot have any impact on the outcome in this case.

B. The Question Presented By Petitioners Has Been Resolved By Congress

Petitioners concede that any conflict among the circuits on pleading scienter in securities fraud cases has been resolved by Congress. The Private Securities Litigation Reform Act of 1995 amends the Securities Exchange Act to provide that "[i]n any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this title, *state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.*" App. 160-61 (emphasis added).

With enactment of this new law, Congress resolved any conflict among the circuits that may have existed as to whether plaintiffs asserting claims under § 10(b) must plead facts that raise an inference of scienter. Petitioners concede that the enactment of this provision "will foster national uniformity as to applicable pleading standards in federal securities fraud actions commenced from December 22, 1995 forward." Pet. at 16. What they do not explain is why this Court should grant a writ of certiorari to resolve a purported conflict among the circuits that Congress itself has now resolved.

The best they can do is to condemn Congress' determination that the new Act's pleading standard "shall not affect or apply to any private action . . . commenced before and pending on the date of enactment of this Act." PSLRA § 108, *reprinted at* App. 183. As wrong as petitioners may think Congress was to determine that the PSLRA's pleading requirements should not apply to this case, however, that is no ground for issuing a writ of certiorari.

Whether an enactment should be given retroactive effect is purely discretionary with Congress, which has the primary "responsibility for fundamental policy judgments concerning the proper temporal reach of statutes." *Landgraf v. USI Film Products*, ___ U.S. ___, 114 S. Ct. 1483, 1501 (1994). Where, as here, Congress has prescribed a statute's reach, this Court's inquiry is ended. *Id.* at 1505. Petitioners may disagree with Congress' determination, but they cannot legitimately ask this Court to step in to do what Congress determined should not be done.

C. The Question Presented Is Irrelevant On The Facts Of This Case, Where Plaintiffs Have Pleaded Facts Sufficient To Raise An Inference Of Scienter Under The Pleading Standard Petitioners Advocate

Review by this Court is particularly inappropriate because the question presented by petitioners can have no practical consequences on the record in this case. Even under Second Circuit pleading standards the Complaint's allegations raise a "strong inference of scienter," for the insider stock sales and offering of securities in this case raise "a strong inference of scienter" under Second Circuit precedents which hold that "[a] common method for establishing a strong inference of scienter is to allege facts

showing a motive for committing fraud and a clear opportunity for doing so." *Beck v. Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987) (citing *Goldman v. Belden*, 754 F.2d 1059, 1070 (2d Cir. 1985)), *cert. denied*, 484 U.S. 1005 (1988); *see Cohen v. Koenig*, 25 F.3d 1168, 1173-74 (2d Cir. 1994).

The Ninth Circuit held that the Complaint in this case alleged securities fraud with the particularity required by Rule 9(b) based on allegations that the defendants made knowingly false statements, bolstered by evidence of securities sales by the Company and its officers which provided their motive for committing fraud. App. 13-14. As the Ninth Circuit observed, the Complaint alleges

> that the optimistic statements permitted the successful offering of 73,000 shares of The Price REIT, which raised some $71 million for the Company. Complaint ¶¶ 36-42. Moreover, the Complaint alleges that two high-ranking company managers were making insider sales at inflated prices of Company stock during the period in which the optimistic statements were being issued. Complaint ¶¶ 13(b)-(c), 17, 68.

App. 13.

The insider stock sales alleged in the Complaint were both substantial and probative of scienter, as the Ninth Circuit noted:

> The Complaint alleges that the Company's Chief Operating Officer for the West Coast and Chief Operating Officer for the Company's East Coast operations – two top executives involved in the expansion program – sold respectively 12,000 and 18,000 shares of Company stock for a total

> of $1.6 million during the period in which the allegedly false statements were being made. The Complaint pleads evidence that these sales represented significant retrenchments of the Company's executives' own positions in the Company's stock: The sales by the COO for the West Coast involved all of the Company stock he had acquired by option during the period in which the optimistic statements were being made; the sales by the COO for the East Coast halved his total holdings in the Company.

App. 13-14.

The Ninth Circuit held that "[t]hese sales are *circumstantial evidence that the defendants knew* or had reason to know that the financial condition of the Company was deteriorating well before they disclosed the problems with the expansion program." App. 14 (emphasis added). These allegations similarly raise a "strong inference" of scienter under the Second Circuit's Rule 9(b) precedents which petitioners praise for applying the "most stringent pleading standard." Pet. at 13.

In *Goldman*, 754 F.2d at 1070-71, for example, the Second Circuit sustained a complaint's allegation of scienter on the basis of an allegation that "failure to qualify . . . bullish statements was intended to permit individual defendants to profit from an inflated market price before the truth became known." *Id.* at 1070. In *Cosmas v. Hassett*, 886 F.2d 8, 12 (2d Cir. 1989), the Second Circuit again held that such allegations of motive were sufficient to raise a "strong inference that the defendants possessed the requisite fraudulent intent":

> In any case, the allegations in the amended complaint herein do establish a motive. The amended complaint asserts that the defendants

> owned shares of Inflight (¶ 6) and that the allegedly fraudulent statements artificially inflated or maintained the prices of Inflight securities (¶ 38). As we stated in *Goldman*, 754 F.2d at 1070: "the . . . implication of the Complaint is that the alleged failure to qualify the bullish statements was intended to permit individual defendants to profit from an inflated market price before the truth became known." In sum, we conclude that the amended complaint satisfied the scienter requirement of Rule 9(b).

Id. at 12-13.

Most recently, the Second Circuit reaffirmed the holding of *Goldman* in *Cohen*, 25 F.3d at 1174. Under *Goldman*, *Cosmas* and *Cohen*, the insider trading allegations in this case suffice to raise a strong inference of scienter under Second Circuit law. Moreover, with *In re Time Warner Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993), *cert. denied*, ___ U.S. ___, 114 S. Ct. 1397 (1994), the Second Circuit held that a rights offering provided a motive to manipulate the price of securities "thereby enabling the company to set the rights offering price somewhat higher than would have been possible without the misleading statements and to lessen the dilutive effect of the offering." *Id.* at 269. This motive – the desire to obtain a higher price for a securities offering – provided sufficient motive to raise an inference of scienter under Second Circuit law. *Id.* at 269-270. The Price Co. REIT offering in this case similarly raises an inference of scienter, even under Second Circuit pleading standards.

In fact, the allegations in this case, as set forth by the Ninth Circuit in its opinion, App. 13-14, provide a much

stronger basis for inferring scienter than do the somewhat weaker allegations in *Goldman*, *Cosmas* and *Time Warner*. Thus, whatever "conflict" might have existed between the Ninth Circuit and Second Circuit precedents before enactment of the PSLRA, it could not possibly have any effect on the outcome in this case.

III. CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

DATED: March 15, 1996

Respectfully submitted,

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No. 95-1347

In The

Supreme Court of the United States

October Term, 1995

THE PRICE COMPANY, ROBERT E. PRICE, DENNIS R. ZOOK and THEODORE WALLACE,

Petitioners,

v.

MAX FECHT, NORMAN COOPER, HAMILTON J. SAH, ELAINE ALGEO and JOSEPH LASENSKY, On Behalf of Themselves and All Others Similarly Situated,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Respondents The Price Company, Robert E. Price, Dennis R. Zook and Theodore Wallace, under Supreme Court Rule 15.6, hereby submit this reply brief addressing arguments raised by respondents in their brief in opposition to petition for a writ of certiorari.

I. The Important Question Presented by This Petition Has Not Been Decided with Respect to Hundreds of Cases Pending in the Federal Courts, and This Court Should Adopt a Uniform and Rigorous Rule 9(b) Standard for These Cases.

Respondents overlook the fundamental fact that this case – and the hundreds of other federal securities fraud actions which were pending in the federal court system as of December 21, 1995 – remain subject to conflicting and divergent interpretations of Rule 9(b) by various circuit courts of appeal, notwithstanding Congress' recent enactment of the Private Securities Litigation Reform Act of 1995 ("the Act"). In particular, the Ninth Circuit Court of Appeals has adopted an anomalous Rule 9(b) pleading standard, which does not evaluate whether pleaded allegations are sufficient to raise an inference of fraudulent intent, but merely inquires whether the pleading alleges some explanation why the challenged statements were false or misleading when made.[1]

---

[1] *Compare In re GlenFed Sec. Litig.*, 42 F.3d 1541, 1548-1549 (9th Cir. 1994) *(en banc) with, e.g., O'Brien v. National Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991); *Greenstone v. Cambex Corp.*, 975 F.2d 22, 25-27 (1st Cir. 1992) (Breyer, J.); *DiLeo*

Because such conflicting interpretations of Rule 9(b) persist notwithstanding passage of the Act, it is just and appropriate that this Court establish a uniform Rule 9(b) pleading standard governing all federal securities fraud actions predating the Act. Petitioners respectfully submit that the most cogent interpretation of Rule 9(b) is the one which requires securities fraud plaintiffs to plead sufficient facts to raise a strong inference of fraudulent intent – the very interpretation rejected by the Ninth Circuit but later enacted into law by Congress.

II. This Court Should Grant the Writ and Expressly Reject Respondents' Position that Allegations of Isolated Employee Stock Sales Are Sufficient to Raise an Inference of Fraudulent Intent Under Rule 9(b).

The district judge in this case ruled that plaintiffs' allegations were insufficient to satisfy Rule 9(b). App. 131, 133. The Ninth Circuit Court of Appeals, however, reversed the district court's judgment of dismissal, applying the Ninth Circuit's own unique and recently fashioned "explanation of falsity" Rule 9(b) standard. Remarkably, respondents in their brief in opposition do not attempt to defend the Ninth Circuit's aberrant Rule 9(b) pleading standard. Rather, respondents assert that the allegations made in this case would satisfy even a "strong inference of fraudulent intent" Rule 9(b) standard. *See* Brief in opposition 6-10.

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v. Ernst & Young, 901 F.2d 624, 630 (7th Cir. 1990), *cert. denied*, 498 U.S. 941 (1990).

In particular, respondents argue that their allegations of stock sales by two company officers suffice to raise an inference of fraudulent intent satisfying Rule 9(b) – thereby authorizing respondents to proceed through the expensive, time-consuming and disruptive pretrial discovery process. This proposition merits critical review by this Court under *any* reasonable interpretation of Rule 9(b).

Respondents' underlying allegations in this case were constructed around two basic *non sequiturs:*

1. An earnings decline was publicly reported on April 2, 1992; therefore, The Price Company defendants must have conspired to suppress negative information about the company's economic condition before them.

2. Two individual officers of The Price Company sold some Price Company Stock in periods before the announced earnings decline; therefore, they must have taken steps to inflate the stock price before they made their sales and must have known the stock price would later decline.

Petitioners respectfully submit that such hindsight speculation fails to state a legally sufficient claim under Rule 9(b) and the federal securities laws.

The phrase "fraud by hindsight" was coined by Judge Henry Friendly in *Denny v. Barber,* 576 F.2d 465 (2d Cir. 1978). In that case, the Court observed that "plaintiff has simply seized upon disclosures made in later . . . reports and alleged that they should have been made in earlier ones" and dismissed the action on the ground that deficient powers of clairvoyance do not constitute

actionable fraud. *Id.* at 470.[2] Judge Friendly's sage remarks about "fraud by hindsight" have been cited and applied in numerous recent decisions adopting a stringent interpretation of Rule 9(b), and are particularly pertinent in this case.[3]

---

[2] The Seventh Circuit aptly has framed the "fraud by hindsight" issue in the following terms:

> The story in this complaint is familiar in securities litigation. At one time the firm bathes itself in a favorable light. Later the firm discloses that things are less rosy. The plaintiff contends that the difference must be attributable to fraud. "Must be" is the critical phrase, for the complaint offers no information other than the differences between the two statements of the firm's condition. Because only a fraction of financial deteriorations reflects fraud, plaintiffs may not proffer the different financial statements and rest. Investors must point to some facts suggesting that the difference is attributable to fraud.

DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990) (affirming dismissal), *cert. denied*, 498 U.S. 941 (1990).

[3] *See, e.g., Greenstone v. Cambex Corp.*, 975 F.2d 22, 25-27 (1st Cir. 1992) ("To permit a securities fraud complaint to state, without more, that the corporation's executives 'knew' in 1991 about the likely decline in 1992 sales would sanction what Judge Friendly called 'fraud by hindsight,' [citation omitted], a practice that courts have not allowed") (Breyer, J.); *Raab v. General Physics Corporation*, 4 F.3d 286, 291 (4th Cir. 1993) ("[P]redictions about earnings for the latter three quarters of 1992 proved incorrect, but hindsight does not establish fraud") (affirming dismissal with prejudice); *Arazie v. Mullane*, 2 F.3d 1456, 1467-1468 (7th Cir. 1993) ("[T]emporal proximity between positive statements stressing a firm's strengths and announcements of poor economic performance do not create an inference that the earlier statements were fraudulent") (affirming dismissal without leave to amend).

First, the retailing industry in which The Price Company operates is among the most competitive in the world. What may appear to be a prudent course to follow early in one quarter may appear to management not to be working successfully when an economic downturn occurs or after management has the benefit of another quarter's experience. Indeed, companies in the retailing business (as well as other rapidly changing industries) are especially vulnerable to suits based on the temporal proximity of hopeful expectations and disappointing results. Corporate officers should not be burdened by the risk that if they tailor corporate strategies to evolving marketplace conditions, their lack of inertia will be viewed as evidence that they were lying in the first place. But the Ninth Circuit's opinion in this case aggravates and actualizes this unfair risk. The Ninth Circuit's opinion holds that a company's announcement of a change in business strategy, made within a few months of the company's optimistic statements about the prior strategy, amounts to "circumstantial evidence" of fraud. App. 12-13.

Second, the Ninth Circuit opinion in this case also holds – and respondents now argue to this Court – that stock sales by two Price Company officers in periods before the April 2, 1992 earnings release constitute circumstantial evidence of fraud. App. 13-14; brief in opposition 6-10. Respondents go so far as to assert – again from the perspective of hindsight – that these alleged insider stock sales suffice to create a "strong inference of *scienter*" under Rule 9(b). Brief in opposition 8. This assertion must be rejected as a matter of both law and logic.

In companies regularly targeted by shareholder suits, incentive stock options typically are a major part of the

overall executive compensation package. As a result, it is to be expected that in any given quarter of the fiscal year, some executives will sell some of their option stock. Whereas "[i]nsider trading in suspicious amounts or at suspicious times" may be probative of motive or intent in a securities fraud action, *see In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1117 (9th Cir. 1989), *cert. denied*, 496 U.S. 943 (1990), this Court should disavow the illogical and unfair notion that allegations of isolated employee stock sales are themselves sufficient to create a strong inference of fraudulent intent which satisfies threshold Rule 9(b) pleading requirements.[4] The Ninth Circuit Court of Appeals itself recognized the correct rule of law in *In re VeriFone Sec. Litig.*, 11 F.3d 865, 872 (9th Cir. 1993), holding that absent legally sufficient allegations identifying an underlying violation of the antifraud provisions of the securities laws, allegations of insider stock sales cannot save a complaint from dismissal.[5]

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[4] Significantly, none of the Second Circuit decisions cited by respondents, fairly read, supports the proposition that allegations of employee stock sales are sufficient to satisfy Rule 9(b) absent substantial other evidence of fraud. *See Goldman v. Belden*, 754 F.2d 1059, 1069-1070 (2d Cir. 1985) (citing numerous detailed allegations concerning circumstances of alleged fraud besides alleged employee stock sales); *Cosmas v. Hassett*, 886 F.2d 8, 11-13 (2d Cir. 1989) (same); *In re Time-Warner Inc. Sec. Litig.*, 9 F.3d 259, 264-271 (2d Cir. 1993) (same); *Cohen v. Koenig*, 25 F.3d 1168, 1173-1174 (2d Cir. 1994) (same).

[5] In *VeriFone*, the Ninth Circuit affirmed a dismissal with prejudice of a shareholder suit notwithstanding allegations that "in excess of 719,900 shares out of the 3.9 million shares of VeriFone common stock" had been sold by company officers and directors during the period of the claimed fraud. *Id.* at 871.

Petitioners respectfully submit that this Court should grant the writ and should affirm that "fraud by hindsight" allegations based upon disappointing quarterly earnings and isolated employee stock sales – which were deemed sufficient in this case by the Ninth Circuit Court of Appeals – do not satisfy the special pleading requirements of Rule 9(b).

CONCLUSION

For all the foregoing reasons, as well as the reasons set forth in their petition, petitioners The Price Company, Robert E. Price, Dennis R. Zook and Theodore Wallace respectfully request that this Court grant a Writ of Certiorari to review the decision of the Ninth Circuit Court of Appeals, which reversed the district court's judgment of dismissal in this case.

Respectfully submitted,

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